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NORTH CAROLINA LAW REVIEW



SYMPOSIUM

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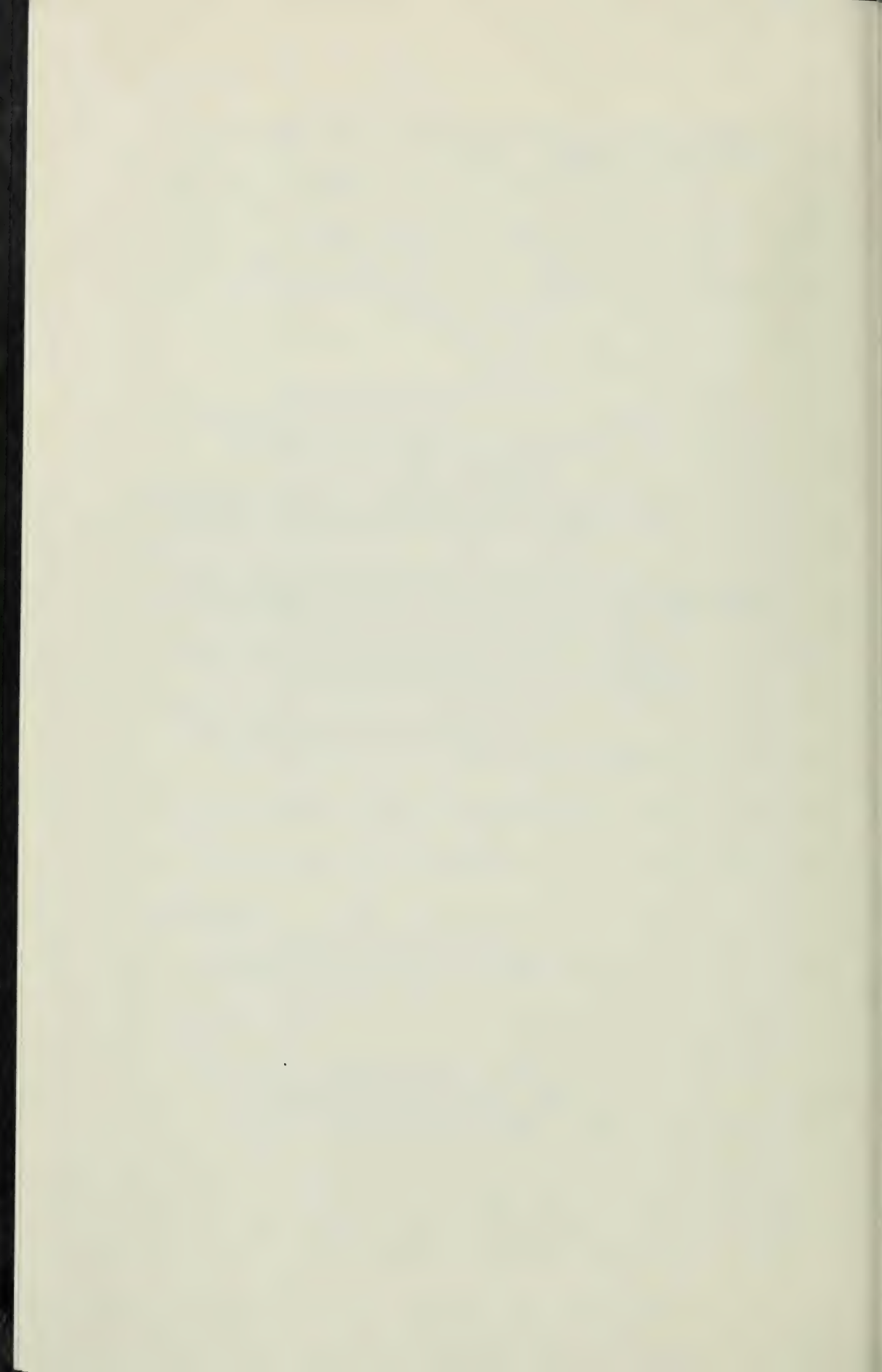
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INTRODUCTION

On August 12, 1969, the House of Delegates of the American Bar Association adopted the Code of Professional Responsibility as a model of ethical conduct for attorneys throughout the country. The Code grew out of the efforts of the ABA Special Committee on Evaluation of Ethical Standards, with John F. Sutton, Jr. as reporter, which was appointed to evaluate the continued vitality of the Canons of Professional Ethics, first promulgated in 1908. In determining that a new set of standards was necessary, the committee identified, in the preface of the Code, four shortcomings of the Canons:

(1) There are important areas involving the conduct of lawyers that are either only partially covered in or totally omitted from the Canons; (2) Many Canons that are sound in substance are in need of editorial revision; (3) Most of the Canons do not lend themselves to practical sanctions for violations; and (4) Changed and changing conditions in our legal system and urbanized society require new statements of professional principles.

Now, a decade after its effective date, similar charges are being leveled with increasing frequency—although perhaps with less urgency and concerning different substantive areas—against the present Code of Professional Responsibility. Among members of the bar there is evidence of increasing apprehension over the effectiveness of the Code, spawned by such considerations as the failure of the Code to deal with a number of difficult issues, to reflect the diversity of the profession, to consider the problem of conflicting standards, to recognize the special situation of the public lawyer, and to alter the common perception of ethical rules as more commendatory than mandatory. From outside the bar, the growing consumer movement for better delivery of legal services, recent Supreme Court decisions on the commercial aspects of legal practice, current antitrust attention by the Justice Department, and heightened public concern with legal ethics in the post-Watergate era have also spurred the movement to reconsider the ethical relationship between lawyer and public.

In light of these criticisms, on August 22, 1977, the ABA appointed the Special Commission for the Evaluation of Professional Standards, with L. Ray Patterson as reporter, to review the need for improvement in the Code. The Commission is now composing a new code dealing with professional standards, a preliminary draft of which is tentatively scheduled for publication in August 1980. The new code, currently

slated to take the form of a restatement, can be expected to make fundamental changes in the formulation of the model for legal ethics.

The purpose of this Symposium is to further these revisory efforts by enlarging the pool of responsible and constructive scholarly criticism that can be drawn upon in reassessing the Code of Professional Responsibility. Reflecting the profession's commitment to a thorough rethinking of the Code, our authors range in their discussions from grappling with broad fundamentals to proposing specific revisions in disciplinary rules. Although at points clearly divergent positions are taken, such as Professor Sutton's and Dean Patterson's suggestions for improvement in the framework of the ethical rules, the authors all endorse some revision, if not wholesale reshaping, of the Code. It is hoped that the ideas presented here will contribute to the creation of more enduring and workable standards of professional ethics.

HOW VULNERABLE IS THE CODE OF PROFESSIONAL RESPONSIBILITY?

JOHN F. SUTTON, JR.[†]

The Code of Professional Responsibility was adopted by the American Bar Association in August 1969. The adoption process was essentially a political one. Two earlier drafts of the proposed Code were exposed to public view, and the reactions of lawyers to those drafts were given considerable weight during the preparation of the final draft. The views of lawyers were considered to be highly important because the Code could be adopted only if it met the approval of the House of Delegates of the American Bar Association.

At the time the Code was being written, lawyers were troubled over impending changes in methods of supplying legal services. Group legal services, prepaid legal service plans, legal clinics, nontraditional legal aid plans and organizations, increasing use of subtle solicitation of clients, and growing tolerance of advertising were on the scene but were loathed by many influential lawyers. The August 1969 version of the proposed Code reflected much of the prevailing reluctance of lawyers to depart from old, familiar standards. The easy acceptance of the Code by the House of Delegates in August 1969 was due in no small part to its generally conservative approach. The politicized, conservative viewpoint that prevails in the Code is particularly evident in its provisions relating to the marketing of (or the availability of) legal services.

Largely as a consequence of the influence upon the Code of the political adoption process, the ABA Code at the outset contained several flaws obvious to many commentators.¹ The provisions regarding advertising,² solicitation of clients,³ specialization, group legal services,

[†] Professor of Law, The University of Texas; J.D. 1941, The University of Texas. Professor Sutton served as Reporter for the ABA Special Committee on Evaluation of Ethical Standards, which wrote the ABA Code of Professional Responsibility.

1. See generally Sutton, *The American Bar Association Code of Professional Responsibility: An Introduction*, 48 TEX. L. REV. 255 (1970).

2. In 1977, two different approaches to the regulation of advertising were suggested to the ABA House of Delegates. Proposal A, which was adopted in an amendment of DR 2-101, used the "laundry list" approach: all advertising is inferentially prohibited unless it falls into one of the many categories found on the check-list or laundry list. Proposal B, which has been followed in a

and other marketing problems were at best inadequate and at worst obstreperous and obstructionistic.⁴ Many problems relating to the representation of clients were dealt with insufficiently; these included the representation of differing interests,⁵ the financing of litigation,⁶ and the duty to act competently.⁷ Other rules requiring serious revision include those relating to trial publicity⁸ and preservation of client confidences when the client is unreasonably endangering others or invading the rights of others.⁹

few jurisdictions, prohibits only public communications that contain a false, fraudulent, misleading or deceptive statement or claim; following the prohibition is a list of seven kinds of statements or claims that are per se violative of the basic proscription. See *House of Delegates Adopts Advertising D.R. and Endorses a Package of Grand Jury Reforms*, 63 A.B.A.J. 1234 (1977). It would seem that Proposal B eventually will prove the better approach.

3. Proposal B included suggested amendments to DR 2-103(A), relating to in-person contacts. *Id.* at 1236.

4. See Nahstoll, *Limitations on Group Legal Services Arrangements Under the Code of Professional Responsibility*, DR 2-103(D)(5): *Stale Wine in New Bottles*, 48 TEX. L. REV. 334 (1970); Smith, *Canon 2: "A Lawyer Should Assist the Legal Profession in Fulfilling Its Duty to Make Legal Counsel Available,"* 48 TEX. L. REV. 285 (1970); Wallace, *The Code of Professional Responsibility—Legislated Irrelevance?*, 48 TEX. L. REV. 311 (1970).

5. See Gibson, *ABA Code Canon 5—Professional Judgment*, 48 TEX. L. REV. 351 (1970).

Regulation of conflicting interests presents a particularly difficult problem. In drafting the Code an attempt was made to broaden ethical disqualification by broadening the concept of conflicting interests. Thus, the rules require, generally speaking, that the lawyer refrain from representing "differing interests," which was defined to encompass not only directly conflicting interests but "every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest." ABA CODE OF PROFESSIONAL RESPONSIBILITY, Definition (1). Nevertheless, lawyers continue to represent differing interests when they should not. Many aspects of the loyalty and differing interests problems should be reconsidered. For example, as a matter of professional practice recommended for normal usage, a lawyer should not undertake to represent two defendants in a single criminal prosecution. EC 5-17 is inadequate in this respect. An excellent discussion of the problem of joint representation of defendants in criminal matters appears in *United States v. Garafola*, 428 F. Supp. 620 (D.N.J. 1977).

Also there are indications that DR 5-101(A), EC 5-5, and EC 5-6 give insufficient guidance when the lawyer is to be named in the client's will as executor, trustee, beneficiary, or lawyer for the estate. A new statement in the ethical considerations outlining recommended normal practices might be of more assistance to both the bar and the public. A statement of recommended normal practice surely would frown upon a lawyer including an in terrorem clause to enforce a suggestion in the client's will that the lawyer be employed as the lawyer for the estate. See generally New York County Lawyers' Ass'n Comm. on Professional Ethics, *Question No. 628*, 97 N.J.L.J. 799 (1974).

6. Certain problem areas related to the financing of litigation include (1) the refund of unearned prepaid fees, (2) financial assistance to the client, and (3) the insurer's payment of legal fees for counsel of the insured's own choosing. DR 2-110(A)(2) and (3) require a lawyer, upon withdrawal from employment, to refund unearned prepaid fees and to deliver to the client "all papers and property to which the client is entitled." Should prepaid fees be deposited until earned in a trust fund in compliance with DR 9-102? *Texas Ethics Opinion 391*, 41 TEX. B.J. 322 (1978), states that such fees, unless clearly not refundable, should be held in trust and any unearned portion should be repaid to the client upon withdrawal of the lawyer.

Nearly ten years have passed since the adoption of the Code. It has been widely adopted and enforced and has been relied upon by the courts in deciding several thousand cases. During this decade, numerous additional difficulties in the Code have been recognized, and vexing questions have been raised concerning many specific provisions of the disciplinary rules. Uncertainties exist because the philosophy underlying certain disciplinary rules and ethical considerations was not sufficiently refined and complete. Unexpected results have occurred because various provisions of the Code have been used in ways not

Should the lawyer be entitled to assert a possessory lien on the client's litigation papers, even though the papers are of no economic value to the lawyer? Or should the lawyer be required to deliver such papers to the client upon withdrawal? The better practice may be to deny the lawyer a possessory lien in the litigation situation. See *Academy of Cal. Optometrists, Inc. v. Superior Court*, 51 Cal. App. 3d 999, 124 Cal. Rptr. 668 (1975); *In re Kaufman*, 93 Nev. 452, 567 P.2d 957 (1977). These questions should be dealt with expressly in the Code.

DR 5-103(B) forbids the lawyer to advance or guarantee financial assistance to the client, with certain exceptions, and it probably has served to cause clients represented by ethical lawyers to accept, out of economic necessity, unduly low settlement offers. DR 5-103(B) was omitted in Texas when the Code was adopted; the omission has occasioned little adverse comment. DR 5-103(B) should be modified and tempered, if not dropped altogether. See also *Mahoning County Bar Ass'n v. Ruffalo*, 176 Ohio St. 263, 199 N.E.2d 396, cert. denied, 379 U.S. 931 (1964); TEXAS ETHICS OPINION 230 (1959).

Courts continue to fumble and sidestep in seeking a solution to the conflicting interest problems arising so frequently between an insured and the insured's liability insurer. See, e.g., *Employers Cas. Co. v. Tilley*, 496 S.W.2d 522 (Tex. 1973) (interesting concurring opinion). A proper solution has been indicated by a few cases: the insured selects his or her own lawyer, and insurer pays the legal fee. See *United States Fidelity & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932 (8th Cir. 1978); *Storm Drilling Co. v. Atlantic Richfield Corp.*, 386 F. Supp. 830 (E.D. La. 1974). That solution should be incorporated into the Code, probably as part of a recommended normal professional usage.

7. See Weckstein, *Maintaining the Integrity and Competence of the Legal Profession*, 48 TEX. L. REV. 267, 273 (1970).

Competence, the subject of canon 6, seems to lie at the very heart of professional responsibility. Nevertheless, much work is required before the Code's standards become nonpareil. Acting competently, rather than *being* competent, is the touchstone. On a disciplinary level, the standard should be intentional, gross and habitual neglect. See ABA COMM. ON PROFESSIONAL ETHICS, INFORMAL OPINIONS, No. 1273 (1973). Due care is too harsh for use as a disciplinary rule because we use hindsight in litigation in judging due care, whether or not we admit that we do. A disciplinary rule involving due care is almost certain to be enforced selectively and raggedly. But due care is a proper standard to be included in a statement of recommended normal usage.

Competence requires adequate preparation, yet a lawyer must guard against becoming overly prepared. To the client paying the bill, detailed preparation on the minutiae of a legal matter may cost more than it is worth; that degree of preparation should not be required by professional standards. An obligation to participate in continuing legal education programs, however, should be included in a statement of professional practices recommended as normal usage.

Whether standards should be lower for legal aid clinics troubled by inadequate finances and heavy caseloads is another difficult question. Curtailing the acceptance of too many cases is not a commendable answer if that action means some individuals will receive no representation at all. See Comment, *Caseload Ceilings on Indigent Defense Systems to Ensure Effective Assistance of Counsel*, 43 U. CIN. L. REV. 185 (1974). See also ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 334 (1974); ABA COMM. ON PROFESSIONAL ETHICS, INFORMAL OPINIONS, No. 1359 (1976).

contemplated by those who wrote it. Furthermore, many lawyers have felt that they were inadequately informed and guided by the Code; this feeling of uncertainty perhaps is largely due to the absence of examples, the lack of elaboration in the ethical considerations, and failure of the Code to distinguish sharply the several purposes served by the ethical considerations.

Beyond question, a substantial review and revision of the Code is needed. The timing is favorable, for lawyers are willing now to accept a more modern, progressive set of norms than they were willing to accept in 1969. Today the real question is not whether the Code should be amended, but the nature and extent of the revision. This question can be answered accurately only after considering the purposes that are served or that should be served by an ethical code for lawyers, and after

8. See *Chicago Council of Lawyers v. Bauer*, 522 F.2d 242 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976), *noted in* 54 TEX. L. REV. 1158 (1976).

9. The broad ethical protection of client confidences probably includes almost everything the lawyer learns during the course of the relationship—or, at least, a “prudent lawyer would not take it upon himself to guess whether something would be sufficiently innocuous to pass this test.” G. HAZARD, *ETHICS IN THE PRACTICE OF LAW* 23 (1978). Few lawyers and scholars argue, however, that the duty to preserve confidences and secrets is or should be absolute. DR 4-101(C) recognizes four exceptional situations in which the lawyer “may reveal,” but is not required by DR 4-101(C) to reveal, the information. In some situations, should the lawyer be required—and not merely permitted—to reveal the information that should be revealed if the countervailing interests of another are to be protected? Do the exceptions (whether they are to be “may” or “must” exceptions) cover all the situations that should be covered? If a lawyer representing a mother in a divorce case in which she seeks custody of a small child learns that the mother in the past has abused the child and if the lawyer reasonably fears she will abuse the child in the future (even though there is no reasonable proof that she presently has the “intention” to do so), should the lawyer be permitted (or required) to reveal that information? New Jersey Advisory Comm. on Professional Ethics, *Opinion No. 280*, 97 N.J.L.J. 361, *supplemented*, 97 N.J.L.J. 753 (1974), struggled to reach the result that the information must be provided to the New Jersey Children’s Bureau. See also *People v. Belge*, 83 Misc. 2d 186, 372 N.Y.S.2d 798 (1975), *aff’d*, 41 N.Y.2d 60, 359 N.E.2d 377, 390 N.Y.S.2d 867 (1976).

The question that remains partially unsolved is this: To what extent should there be a duty upon a lawyer to volunteer to tell the truth when the truth was obtained from a client, is likely to be detrimental to the client, and is something that the client thought would never be used against him? The answer to this question involves the scope of any revision of DR 4-101 and DR 7-102(B). Helpful guidance may be obtained from Callan & David, *Professional Responsibility and the Duty of Confidentiality: Disclosure of Client Misconduct in an Adversary System*, 29 RUTGERS L. REV. 332 (1976) (containing specific suggestions for revision); Levine, *Self-Interest or Self-Defense: Lawyer Disregard of the Attorney-Client Privilege for Profit and Protection*, 5 HOFSTRA L. REV. 783 (1977). It must be kept in mind also that in some states lawyers are forbidden by statute to reveal a confidence of a client. See, e.g., TEX. CODE CRIM. PRO. ANN. art. 38.10 (Vernon Supp. 1978).

Resolution of the problem is particularly difficult in the situation in which a client in a criminal prosecution has committed perjury or has insisted upon taking the stand and is going to swear falsely, to the lawyer’s knowledge. Compare Comment, *Attorney-Client Confidentiality: New Approach*, 4 HOFSTRA L. REV. 685 (1976), and Frankel, *The Search for Truth: An Umpireal View*, 123 U. PA. L. REV. 1031 (1975), with ABA STANDARDS RELATING TO THE DEFENSE FUNCTION § 7.7. See also *In re A*, 276 Or. 225, 554 P.2d 479 (1976) (failure to disclose in divorce action; withdrawal deemed proper course of action).

contemplating the specific ways in which the Code fails to serve those purposes fully.

STANDARDS FOR LAWYERS

The main purpose of a professional code is to state standards for the profession. There are several kinds of standards, and any professional code will prove confusing and inadequate unless it makes clear the particular kind or kinds of standards it contains.

Three kinds of standards are relevant to the legal profession: regulatory laws; standards of normal professional practices; and ethical norms of aspirations and professional objectives. Any statement of lawyers' professional responsibilities necessarily is incomplete unless it involves all three kinds of standards. To a considerable extent, each kind of standard encroaches upon the other two, and not all commentators will agree upon the scope or meaning of each of the three.¹⁰

Regulatory laws are increasingly being used to control almost all occupations. Not unusual is the regulatory climate in Texas, where more than sixty-five occupations are licensed and regulated by law. The practice of law is one of these regulated occupations. The practice of law is also regulated by law in every other state. Some of the regulations are found in statutory law, and other regulations appear in court rules. The disciplinary rules of the Code constitute an important part of the regulatory law enforced by the states against lawyers. In every state, the disciplinary rules have been adopted by statute or court rules, or have been enforced by courts without formalization into statutes or court rules.¹¹ The disciplinary rules were intended to be used solely as regulatory rules governing lawyers; those rules are penal in nature, and a lawyer is to be penalized for violation of any of those regulatory

10. An interesting comparison is found in Geoffrey C. Hazard's excellent discussion of legal ethics. See G. HAZARD, *ETHICS IN THE PRACTICE OF LAW* (1978). He refers to "the concept of a profession as a regulated vocation," *id.* at 17, and in that sense the profession's ethics is "properly a matter of positive law of the same character as laws governing a regulated business," *id.* at 5. But a code of legal ethics need not be merely regulatory law, or "need not be a legal definition of terms on which the profession may be practiced. It can be merely an admonition that there should be compliance with definitions supplied by precept and example." *Id.* at 15-16. A code of legal ethics may also be—as used in the Code's ethical considerations—"guides that a lawyer may consider in making the ethical assessments that are within his personal discretion." *Id.* at 6.

11. In most states, varying modifications appear in the ABA Code's disciplinary rules. Extensive modifications were made in California when the disciplinary rules were incorporated into statutory law. Compare Rules of Professional Conduct of the State Bar of California, CAL. BUS. & PROF. CODE foll. § 6076 (West Cum. Supp. 1979), with ABA CODE OF PROFESSIONAL RESPONSIBILITY.

rules.¹²

In one sense, the practice of law is merely one of many occupations. It differs from other regulated occupations in being more nearly self-regulated; in the past lawyers have been able to act almost alone in preparing the regulations with which they are required by law to comply. If the practice of law is nothing more or less than a regulated occupation, the only standard needed in a code is a body of regulatory law, such as the disciplinary rules. But lawyers think of themselves as professionals and think that there is some real significance attached to being a professional, a significance that distinguishes the legal profession from other regulated occupations such as bartenders, barbers, boxers, auctioneers, cottonseed growers, commercial fishermen and draymen. If being a professional does have some added significance, the significance may lie only in the added education and skill involved in the profession. More likely, the significance involves professional morale, or the feeling both within and without the legal profession that lawyers' goals involve more than mere adherence to regulatory law.¹³

12. No distinction is made in the present disciplinary rules regarding the punishment to be assessed for minor matters as distinguished from serious violations. The situation is comparable to a penal code in which anything from overparking to murder and treason can be punished by a fine of \$1.00 or more, by imprisonment for any period of time, or by death. Probably it would be worthwhile to attempt to divide the disciplinary offenses into two or three categories with a more appropriate range of punishment for each.

Another problem with the disciplinary rules involves the enforcement mechanism. To what extent can we reasonably expect a lawyer voluntarily to police the profession? Is it realistic to expect the lawyer to seek out disciplinary authorities and inform on himself and other lawyers and judges? Should the young associate be required, under penalty of discipline, to "blow the whistle" on his seniors in the firm? If so, what standard of scienter should be required? Knowledge beyond a reasonable doubt that the erring lawyer has violated a disciplinary rule? Suspicion that evidence could be found that would be sufficient to raise a fact issue of misconduct? Answers to these questions will indicate the direction to be taken in any revision of DR 1-103(A) and (B) and, possibly, DR 7-108(G). Also affected are EC 1-3 and DR 1-101(B).

13. To what extent should the Code regulate the private life of a lawyer, or the lawyer's activities that do not involve legal services? Perhaps the Code should include disciplinary rules that will result in discipline of a lawyer for activities in the lawyer's private life if those activities would be a proper basis for excluding an applicant for admission to the bar. Otherwise, the Code should not attempt to regulate the activities of a lawyer when the lawyer is serving in a capacity not involving the work of a lawyer. Therefore, the Code would not be applicable to a person (even though the person is a lawyer) who is serving as governor, legislator, or truck driver, although it would apply to an attorney general or counsel to the governor. With these reflections in mind, revision of DR 1-102 and DR 8-101 should be considered.

There has been some criticism of the "moral turpitude" standard of DR 1-102(A)(3). See Weckstein, *supra* note 7, at 276-78. Subdivision (4), or "conduct involving dishonesty, fraud, deceit, or misrepresentation," deals with the kinds of misconduct that reflects a lack of good moral character; therefore, subdivision (4) should apply to all conduct of a lawyer.

Subdivisions (5) and (6), while relevant in theory, are too vague in scope. See *id.* at 275-76. These two provisions do not give fair notice and should be revised. Unfortunately, courts are upholding the constitutionality of these two provisions. See, e.g., *In re Rook*, 276 Or. 695, 556 P.2d 1351 (1976).

If so, a professional code should deal with other standards, in addition to the standards of regulatory law.

Each occupation has its own standards that typically are observed by, or should be observed by, members of that occupation. These standards or norms may be written or unwritten, and they may have developed as a matter of custom. In any event, however, there is a standard of conduct that one member of the occupation generally expects of another person engaged in that same work. Some of these customary or normal occupational practices will have become so important to the proper functioning of the occupation that, if the occupation is a regulated occupation, those important normal occupational practices will have been embodied into the regulatory laws; but many will not have.

Examples of occupational norms can be found in every line of work. Normally a cowboy will train a horse to be mounted from the left, and a member of that occupation will think ill of a cowboy who trained a horse to be mounted only from the right. Even though no regulatory law requires that standardized conduct, it is a standard or normal practice in the occupation. Similarly, the derrickman and the floorman on an oil drilling rig will expect each other to conform to standard practices in racking drillpipe; if the standard is not met, someone likely will be injured. A member of an occupation must conform to the standards of normal practice in that occupation if the occupation is to function properly. Indeed, a failure to conform to the standard practices of a profession or other occupation may constitute actionable negligence if the failure to conform is so substandard that an unreasonable risk of harm to another's person or property is created.

An occupation involving only simple, routine tasks has little need for a formalized written statement of normal occupational practices. For those occupations, the usual training and apprenticeship provide ample awareness of normal practices. In more complicated occupa-

Consideration should be given to a restatement of subdivisions (5) and (6) that changes the present rules to state that a lawyer shall not engage in conduct involving the obstruction of justice or other conduct that demonstrates the lawyer presently lacks the good moral character requisite for the practice of law.

If disciplinary regulation should not apply to a lawyer's conduct that is unconnected with his legal services (except as provided in DR 1-102), revision of DR 8-101 will be necessary. Since the disciplinary rules are often adopted as rules of court and thus become regulatory law, the separation of powers doctrine indicates that regulation of the conduct of lawyers when serving as legislators or administrators is unwise. *See generally* SPECIAL COMM. ON CONGRESSIONAL ETHICS, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK, CONGRESS AND THE PUBLIC TRUST (1970).

tions—for example, electricians, plumbers, commercial pilots—carefully prepared statements of normal occupational practices are needed. The occupational literature of those occupations usually will suffice.

Most professions involve the performance of a variety of highly complicated tasks. A member of such a profession has a great need to be able to refer from time to time to a written detailed analysis of the normal professional practices of that profession. There is, however, a correspondingly great difficulty in preparing a statement of the standards of normal practices for a complex profession. For example, a statement of normal practices for physicians would be incomplete unless it was virtually an encyclopedia of the state of the art in medicine, surgery and psychiatry. The legal profession is complex, involving the performance of a variety of highly complicated tasks. A statement of the standards of the normal professional practices of lawyers must consider, in order to be complete, the diversity of the problems encountered in, for example, the practice of criminal law, corporate security law, tax law, admiralty, and personal injury practice, and must consider the diversity of the work of corporate house counsel, patent lawyers, prosecutors, and government lawyers. The preparation of a comprehensive, detailed statement of the standards of normal professional practice for all lawyers is a formidable task. Nevertheless, the scant attention paid by the Code to a statement of standards of normal professional practices—as distinguished from standards of regulatory law—is a main source of dissatisfaction with the Code.

The standards of normal professional practice for the practice of criminal law have been stated in detail and with considerable clarity in two reports prepared by the American Bar Association Project on Standards for Criminal Justice. The Standards Relating to the Prosecution Function and the Standards Relating to the Defense Function contain both "black-letter" statements and commentary regarding the professional practices that are recommended for normal usage. Those two Standards have been exceedingly helpful as guides for lawyers and courts. They have been cited in many opinions as accurately reflecting proper standards of professional practice for lawyers to follow in criminal matters.

Necessarily, statements of standards for normal professional practice to an extent will overlap regulatory law in the area, even though the purpose of regulatory law is to "define socially intolerable con-

duct,"¹⁴ which must be penalized in order to protect society, rather than to guide lawyers toward the practices that seem most suitable in carrying out lawyers' tasks. The Standards Relating to the Prosecution Function and Standards Relating to the Defense Function carefully mark the distinction between standards of regulatory law (disciplinary rules) and standards of normal professional practices. In each Standard it is pointed out that the discussions relate to standards of normal professional practices except when the existence of controlling regulatory law is red-flagged. In the Standards, the term "unprofessional" is used to indicate conduct violative of regulatory law:

The standards proposed in these reports on The Prosecution Function and The Defense Function also seek to avoid some of this confusion by stating, whenever possible, that, subject to special circumstances of justification or mitigation, certain types of conduct characterized as "unprofessional" should result in disciplinary action against the lawyer. Where this is not stated, these standards are intended to serve as guides to honorable practice.¹⁵

Any revision of the Code likewise should distinguish between standards of regulatory law, the violation of which "should result in disciplinary action against the lawyer," and standards of normal professional practice, which "are intended to serve as guides to honorable practice." Regulatory law serves to rid society of lawyers who have proven to be unfit to act as fiduciaries and trusted advisers and representatives. The utility of standards of normal, professional practices is quite different. Statements of normal professional practices serve to educate law students, the bar and the bench in regard to the specifics of "honorable practice." Statements of normal professional practice also tell the public what normally may be expected of honorable, competent lawyers. A lawyer whose conduct falls below the standards suggested by statements of normal professional practices accordingly may be adjudged to be incompetent or negligent, or "unethical" or something less than "honorable," even though the conduct has not fallen below the minimum level of disciplinary rules or other regulatory law.¹⁶

14. Discipline of lawyers is penal in nature. A lawyer may be barred, permanently or temporarily, from practicing law and earning a living. Even a public reprimand may have seriously detrimental effects on a lawyer's practice. Thus, the purpose of the regulatory law for lawyers can be said to be "to define socially intolerable conduct, and to hold conduct within limits which are reasonably acceptable from the social point of view." R. PERKINS, *CRIMINAL LAW* 4 (2d ed. 1969).

15. ABA STANDARDS RELATING TO THE PROSECUTION FUNCTION AND STANDARDS RELATING TO THE DEFENSE FUNCTION 10.

16. DR 2-106(A) and EC 2-17, relating to fees for legal services, demonstrate the difference between a standard stating professional practices that are recommended for normal usage and a

Even though the drafters of a professional code will have difficulty in punctiliously distinguishing regulatory law from standards of normal professional practices, a failure to differentiate between the two has had and will continue to have unhappy consequences. If a professional code fails to observe this distinction, it is likely to contain statements conceptualized on the level of normal professional practices but used for unduly harsh disciplinary purposes; such standards will be enforced unevenly and discriminatively. Similarly, a code that does not distinguish regulatory standards from standards of normal practices is likely to contain some standards conceptualized as regulatory rules but assumed by lawyers to be "guides to honorable practice" with the result that normal professional practices may deteriorate.

Ethical norms of aspirations and professional objectives are closely akin to standards of normal professional practices. In one sense, they are the same. If one is correct in thinking of "ethics" as being an area of free choice, where one is free to follow one's own conscience, a professional code containing regulatory law (or standards that will result in penalties unless followed) necessarily leaves to the lawyer's conscience all matters not controlled by the regulatory standards. Thus, in the Code, all matters not controlled by the disciplinary

standard of regulatory law. The professional practice that is recommended for normal usage is to charge a fee that is reasonable under all the circumstances. EC 2-17, which states the practice that is recommended for normal usage, provides that "a lawyer should not charge more than a reasonable fee." (It is impossible to make a check list of every factor that might, in any given situation, logically affect the reasonableness of a fee; DR 2-106(B) lists eight factors commonly present, but both DR 2-106(B) and EC 2-18 recognize that the list is incomplete.)

A regulatory law (a disciplinary rule) could state that a lawyer is subject to discipline for charging a fee in excess of a reasonable fee. But a regulatory rule to that effect would be excessively harsh. Whether a fee is reasonable is a question that cannot be answered with mechanical precision. A dozen lawyers are likely to have a dozen different opinions on what is a reasonable fee in any given situation. Nevertheless, when the question is litigated, whether in an action involving the allowance of a fee or in a disciplinary action, the question must be answered. Often the amount of fee set or requested by a lawyer will be deemed higher than reasonable, even though the lawyer set the fee in good faith. In short, it is unduly harsh to discipline a lawyer merely because he set a fee that in retrospect at the time of the hearing appears to be unreasonably high. A disciplinary rule regulating fees should be based on bad faith. But bad faith exists, even though the lawyer testifies he thought the fee was reasonable, if the fee is so obviously and clearly excessive that a fact finder would be justified in finding bad faith despite the lawyer's denial. Thus, the regulatory law of DR 2-106(A) differs from the recommended professional practice set out in EC 2-17. Even though a lawyer should not charge more than a reasonable fee, the penalty of disciplinary action will not be visited upon the lawyer unless the fee is "clearly excessive."

To use the standard of EC 2-17 as a regulatory law would be a mistake. To consider the standard of DR 2-106(A) as the level of recommended normal usage likewise would be a mistake. The two standards serve different purposes. The standard of DR 2-106(A) is not helpful as a guide to normal practice, and it is not needed insofar as enforcement of the fee contract is concerned because contract law controls; nevertheless, it serves a necessary function as a disciplinary standard. *But see* G. HAZARD, *supra* note 10, at 99. *See also* Florida Bar v. Moriber, 314 So. 2d 145 (Fla. 1975).

rules involve situations in which the lawyer is free to follow his or her own conscience without fear of formal sanctions. Thus, statements of normal professional practices are truly statements of ethical norms except to the extent that the statements of normal professional practices are identical with, or also identified as, regulatory law.

In another sense, however, ethical norms are distinguishable from standards of normal professional practices. The lawyer with high professional morale and a strong belief in his own capabilities, and who is highly motivated and confident of the excellence of our legal system and of the importance of lawyers to society, will strive to achieve an excellence far beyond the reach of the average lawyer. That inspired lawyer may seek to achieve acclaim as a strong protector of the poor or as the outstanding trial lawyer of the community. That lawyer's goals may be far higher than goals inferentially suggested by the regulatory rules and the standards of normal professional practices. In seeking to gain insight into the legal profession's appropriate values and aspirations, that lawyer can use more assistance than can be obtained by studying the profession's penal requirements or the profession's standards for normal practices. Instead, that lawyer desires to know the reasons underlying the regulatory laws and underlying the standards of normal professional practices, and wants to "reflect on the special services his profession renders to society and the services it might render if its full capacities were realized."¹⁷ For that lawyer, a professional code that states only regulatory rules and standards of normal professional practices is insufficient. To meet the needs of the inspired lawyers with high professional morale, the professional code also should contain statements of the profession's aspirations and the "objectives toward which every member of the profession should strive."¹⁸ To the extent that statements of ethical norms contain guidance toward the profession's aspirations and objectives, the statements are essentially unlike either regulatory law or standards of normal professional practices.

A great shortcoming of the prior Canons of Professional Ethics was its failure to distinguish between regulatory rules and ethical

17. *Professional Responsibility: Report of the Joint Conference*, 44 A.B.A.J. 1159 (1958).

18. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement. For example, EC 2-24 and EC 2-25 recognize that every lawyer should participate in rendering legal services to those who have unusual difficulty in obtaining the services of a lawyer. Those statements are not particularly inspirational, however, and the problem does not lend itself to solution by use of disciplinary rules. Development of a statement of normal standards, or standards recommended for normal usage, for acceptance by each lawyer of a fair share of *pro bono* work is desirable.

norms of aspirations.¹⁹ The Code of Professional Responsibility makes clear that the regulatory rules (or disciplinary rules) are "mandatory in character" and "state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action,"²⁰ whereas the ethical norms of aspirations (or ethical considerations) "are aspirational in character and represent the objectives toward which every member of the profession should strive."²¹

Yet the Code has its own Achilles' heel. The Code is equivocal regarding standards of normal professional practices. Some regulatory provisions of the disciplinary rules coincide with normal professional practices, but the conduct permitted under some regulatory rules is less commendable than one would expect if the disciplinary rules had been designed as standards of normal professional practices. Since the disciplinary rules were designed as regulatory law, the Code should have indicated clearly the situations in which conduct complying with those regulatory rules would nevertheless be substandard when measured against the recommended professional practices. That indication could have been made in the ethical considerations, but the ethical considerations vacillate between being statements of normal professional practices, ethical norms of aspiration and mere explanatory amplifications of the regulatory rules. Considerable confusion has resulted. The Code furnishes poor guidance regarding the conduct normally expected of a lawyer and is inadequate as a teaching tool concerning the conduct to be expected of an honorable lawyer in a variety of situations.²²

A not unlikely reaction to this deficiency of the Code would be to revise it so that it becomes nothing more than a statement of normal professional practices. Another similar reaction might be to simplify the Code by making it merely a set of regulatory rules for use in penalizing erring lawyers. Either course would be unwise. Difficult as it is to deal adequately with all three kinds of standards, a complete professional code must do so, unless the resulting complexity will defeat its

19. See Weckstein, *supra* note 7, at 272-73.

20. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement.

21. *Id.*

22. The Code obviously contains many statements on the level of professional practices that are recommended for normal usage. To the extent that those statements duplicate disciplinary rules, considerable repetition between the ethical considerations and the disciplinary rules is involved. Yet the Code's normal usage statements are incomplete, particularly because of the omission of illustrations regarding various kinds of legal work. A complete text of recommended normal usage would be voluminous, comparable to the numerous volumes of standards prepared by the American Bar Association Project on Standards for Criminal Justice.

usefulness. The Code presently is quite complex,²³ but nevertheless it inadequately states standards of normal professional practices. Perhaps lawyers desire to have in the Code only a statement of normal professional practices. If so, the Code should be revised in the form of the Standards Relating to the Prosecution Function, making it clear that its standards are not designed to be used as regulatory rules. As a consequence, the legislature and courts of the several states would have to formulate their own regulatory rules governing the legal profession.

Possibly, lawyers may desire to have only regulatory rules (perhaps with interpretative commentary) in the Code. If so, the Code should be revised in the form of regulatory rules and explanatory commentary, expressly eschewing any intent to state normal professional practices. In that event, lawyers seeking information regarding normal professional practices can look to law review articles and to court opinions involving such issues as incompetence of counsel and lawyers' tort liability; or perhaps even another bar committee can be induced to prepare standards for honorable professional practice similar to the Standards Relating to The Defense Function, which cover standards of normal professional practices in criminal law.

Lawyers are unlikely to desire to have the Code cover only the ethical norms of aspirations and professional objectives. If any of the three kinds of standards are to be omitted in a revision of the Code, the ethical norms of aspirations are the most likely candidates. In that event, lawyers can look to other writings for inspiration regarding our professional aspirations and objectives.

THE NATURE OF LAWYERS' ETHICAL PROBLEMS

A lawyer normally acts in a representative capacity.²⁴ Whether the lawyer is serving as adviser, advocate, negotiator, or scrivener, or is acting in some other capacity, he is normally working on behalf of a client. Usually, however, lawyer and client are not the only ones involved. Also involved are opposing parties, witnesses, judges, other

23. See G. HAZARD, *supra* note 10, at 19.

24. Since I am a proceduralist, it is not strange that my present view is that the central function of the lawyer—the function that he alone is capable of fulfilling in our complex democracy—is to stand beside his client and protect him as an individual. The kernel of the American lawyer's ethos is, I believe, a fierce independence and will to protect the client whose welfare is entrusted to him.

Weinstein, *On the Teaching of Legal Ethics*, 72 COLUM. L. REV. 452, 457 (1972).

lawyers, other persons engaged in the negotiations, those who are affected indirectly, and, in a very real sense, society itself.²⁵ Therefore, most professional standards have as their primary purpose the solving of tensions created by the juxtaposition of the needs of the clients and the needs of others (including the lawyer).²⁶

Generally speaking, the tensions are alleviated by providing professional standards that delineate with reasonable accuracy the extent to which the lawyer's obligations to client are limited by the needs of the others.²⁷ The areas of tension between clients and other persons can be categorized with moderate accuracy. The professional standards should be concerned primarily with the extent of, or the limitations upon, the lawyer's obligations to the client in accepting employment, acting competently, maintaining confidentiality, being loyal, and pursuing zealously the goals desired by the client.²⁸

There are other lesser tensions. Ethical aspirations and objectives of the profession include constant improvement of law, of the legal profession, of the legal system, and thus of society. An individual lawyer's desire to follow those ethical norms of aspirations on occasion may create tensions with clients.²⁹ A professional code should seek to identify and rectify these lesser tensions.

FORMAT OF A PROFESSIONAL CODE

The Code of Professional Responsibility is now divided primarily into nine parts. Each part is called a canon. Each of the nine parts might well have been considered as a chapter. Of the nine parts (or canons or chapters), six or seven deal with areas of tension identified above. Thus, canon 2 pertains to accepting employment; canon 6 relates to acting competently, canon 4 involves maintaining confidentiality; canon 5 covers conflicting interests of lawyers and clients and of two or more clients as well as related topics, which in the aggregate can be classified as questions of loyalty; canon 7 deals in detail with the zealous pursuit of the client's goals; and canons 1 and 8 tend to resolve

25. These "others" who may be affected are not well identified in the Code. See G. HAZARD, *supra* note 10, at 8.

26. For an interesting discussion of the pressures at work upon the lawyer, see Weinstein, *supra* note 24, at 459-67.

27. To the extent that a lawyer owes affirmative duties to one not a client and in opposition to some interest of the client, standards must state the nature and extent of the affirmative duty to others, in addition to stating the limits of the lawyer's duty to client.

28. See also G. HAZARD, *supra* note 10, at 20.

29. See EC 7-17, 8-4.

the lesser tensions involved in the profession's ethical objectives of improvement of law, the legal profession, the legal system, and society. The intent of those who drafted the Code was to deal separately and in detail with each area of tension affecting the attorney-client relationship.

The Code's format is akin to a "problem" approach. Each chapter (or canon) is concerned with alleviating the tensions in the attorney-client relationship caused by a particular problem or issue. For example, to what extent should a lawyer be zealous on behalf of a client in opposition to the recognizable needs of others?³⁰ To what extent should a lawyer be protective of the confidences and secrets of a client when the needs of others clearly would be served by disclosure?

Unfortunately, the organization of the Code is flawed by the inclusion of two canons that appear to be related more to professional self-protection than to lessening tensions in the attorney-client relationship. These are canon 3, "A Lawyer Should Assist In Preventing The Unauthorized Practice Of Law,"³¹ and canon 9, "A Lawyer Should Avoid

30. The basic thrust of canon 7 is necessary for the proper functioning of the adversary system as it exists in the United States today. (This is not to say that canon 7 should not be reexamined in regard to the lawyer's work in roles other than that of advocate.) This basic rule of duty under canon 7 is that the lawyer is "To Represent His Client Zealously Within The Bounds Of The Law," and is enforced by disciplinary rules and professional regulations. EC 7-1. DR 7-101(A)(1) virtually the same standard on a disciplinary level.

Each litigant usually feels that justice is on his or her side. The litigant feels that a lawyer who would do anything to aid the other side—unless the aid is required by law—is a traitor bent on undermining justice. Advocates, too, get caught up in the emotions of the battle. The litigant's lawyer likely will find it difficult to maintain objectivity. The advocate who is really fighting for his client is not in a position to make—or be required to make—delicate ethical decisions. The limitations upon the advocate's zeal should be spelled out in precise rules and law. The advocate must be permitted to urge his client's cause zealously within the bounds of the law, and should not be required to pawn off his own values onto the client. If it were otherwise, litigants would lose their belief that our legal system permits any individual to fight hard for his cause in our courts. If that belief were to be lost, the feeling that our system serves justice also would be lost.

Insofar as the advocate is concerned, the only problem with the basic thrust of canon 7 is that it subjects the lawyer to the charge that he serves merely as a "mouthpiece." Not so. The adversary system can be modified, and the conduct of the advocate regulated, in whatever respect seems advisable. The regulations, however, must be specific and binding and not hortatory. One binding regulation, DR 7-102(A)(1), (2), specifies the test for the kind of litigation a lawyer may handle and the kinds of positions the lawyer may take in handling the litigation. The standard forbids the taking of any steps for a client if the purpose is merely to harass or maliciously injure a person, and forbids the presentation of a claim or defense in litigation that the lawyer cannot support in good faith. The same standard appears in DR 2-109. While the standard appears to be a proper one, it has been criticized. Because of the criticism, the standard should be reexamined, even though the right of access to our courts is so important in our political system that neither a litigant nor his lawyer should be penalized for presenting a nonfrivolous claim or defense that proves eventually to lack merit.

31. DR 3-102 and DR 3-103 prohibit the sharing of legal fees with nonlawyers and the forming of partnerships with nonlawyers "if any of the activities of the partnership consist of the practice of law." Despite the existence of three specific exceptions to DR 3-102, the rules are too

Even The Appearance Of Professional Impropriety." A professional code should be concerned with standards needed in order for the profession to perform its proper functions in society and should not be concerned with avoiding either competition³² or unfounded criticism. These two canons do contain some worthwhile regulatory rules and ethical norms. Nevertheless, in any revision of the Code canons 3³³ and 9 should be omitted, and the meritorious standards now contained in those canons should be placed elsewhere as needed for the protection of clients and society.

Obviously, a professional code need not necessarily be organized with emphasis on the tensions to be resolved, nor according to a problem approach. At least two other alternative formats are likely to be considered by one pondering the revision of the Code. One approach is to subdivide the Code not into its present nine parts but according to the persons who are involved. A Code in that format might have separate chapters or subdivisions dealing with duties to clients, duties to judges, duties to witnesses, duties to unrepresented parties, duties to society, and so on. Aside from identifying those likely to be affected by the work of lawyers, organization of a professional code according to the persons involved has little merit and is likely to create additional confusion because of the natural tendency to state duties to one participant in a way that apparently will conflict with duties to another. Ten-

stringent. The rules usually are justified on the basis that the bar has an obligation to protect the public from incompetent lay practitioners and that a lawyer is likely to be encouraging a layperson to practice law unlawfully if the layperson receives a financial reward from the association with the lawyer. Occasionally the justification given in support of DR 3-102 and DR 3-103 is that they prevent improper solicitation of potential clients. If that is the justification, the rules are overbroad and prohibit far more than is necessary in order to prevent the use of "runners" or other third persons who may mislead, overreach or otherwise behave improperly in attempting to obtain clients for the lawyer. If, however, the layperson is competent and if both lawyer and layperson are acting within their own areas of competency, the client may be benefited—or, at least, not harmed—by conduct that does not conform to DR 3-102 and DR 3-103. Those disciplinary rules should be restudied. *See* *Blumenberg v. Neubecker*, 12 N.Y.2d 456, 191 N.E.2d 269, 240 N.Y.S.2d 730 (1963); ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 180 (1938). *But see* *Columbus Bar Ass'n v. Agee*, 175 Ohio St. 443, 196 N.E.2d 98 (1964).

An analysis of the policy considerations underlying DR 3-102 and DR 3-103 should also involve DR 5-104(A), which places severe limitations upon business arrangements between lawyer and client. Who is harmed if, for example, a lawyer and a petroleum geologist form a partnership to engage in the business of discovering and developing new oil fields, with the lawyer furnishing the legal services and the geologist the geological services? A layperson who enters into a business arrangement with a lawyer may need a degree of protection against the possibility that the lawyer will look after his own interests at the expense of the layperson while lulling the layperson into believing that there is no conflict of interests. Even so, DR 5-104(A) may be unduly restrictive.

32. *See* Sutton, *The Impact of the Code of Professional Responsibility upon the Unauthorized Practice of Law*, 47 N.C.L. REV. 633, 634-36 (1969).

33. *See* Sutton, *supra* note 1, at 259.

sions in the attorney-client relationship would be increased rather than resolved.

The second method likely to be considered is one that subdivides the professional code according to the various roles a lawyer performs: advocate, adviser, negotiator, draftsman or "one who designs the framework of collaborative effort,"³⁴ public servant, arbitrator,³⁵ administrator, and so on. That organization serves to focus attention upon the variety of functions performed by a lawyer. That form may be counterproductive, however, because at best the statements of standards will be highly repetitious, function by function, and at worst the statements under each function might contain unnecessary variations, attributable to a desire to avoid boring repetition rather than a desire to formulate different standards.

Other organizational patterns, logical or illogical, may be suggested. No one format is inherently superior to others. The best organization of a code for lawyers is the one that best aids the revisers of the code to: (1) state separately, with clear delineation, each of the three standards (regulatory rules, standards of normal professional practices, and ethical norms of aspirations); (2) state the regulatory rules with sufficient precision to give lawyers fair notice of the minimum, enforceable standards, and with sufficient restraint that disciplinary authorities will not hesitate to enforce the regulatory rules uniformly and vigorously;³⁶ and (3) identify and resolve all tensions arising out of the lawyer's professional work.

One negative effect of changing the format of the Code should not be overlooked. Ten years ago, lawyers were accustomed to the arrangement and language of the old Canons of Professional Ethics. Consequently, they had difficulty in locating desired material in the new Code. Lawyers and courts now are familiar with the Code. Because of the general familiarity with the present format and language of the Code, changes should be made only when helpful in stating standards more accurately, more completely, or more understandably. Unnecessary changes in either format or language will be counter-

34. *Professional Responsibility: Report of the Joint Conference*, *supra* note 17, at 1161.

35. See EC 5-20.

36. Making dual use of standards that correctly state recommended professional practices by using them as disciplinary standards will, almost surely, result in some unduly harsh disciplinary rules. Unrealistically harsh disciplinary standards will not be enforced uniformly and vigorously. The lawyers against whom such standards are likely to be enforced are the unpopular lawyers, the lawyers with high visibility, and the lawyers who represent unpopular causes and unpopular clients.

productive, involving another long period during which lawyers will have to become acquainted with the revised Code. This is not to say that the Code should not be revised extensively. The point is that no unnecessary changes should be made.

THE CODE'S UNNECESSARY IMBROGLIOS

The Code has been described as "a complex document."³⁷ Part of the Code's complexity is its division into canons, ethical considerations, and disciplinary rules. The disciplinary rules are mandatory regulatory rules, but neither the canons nor the ethical considerations were intended by the Code's drafters to be enforced or to be binding. The canons are merely general concepts used as chapter headings and the ethical considerations are primarily aspirational in character. Many authorities have missed the point, however. Consequently, the canons and the ethical considerations often have been "enforced" as though they were regulatory rules or law. In particular, canon 9, "A Lawyer Should Avoid Even The Appearance Of Professional Impropriety," has been misused.³⁸ The nature of the canons has not been noted by some other observers who have protested a failure to define a word used in a canon, such as "zealously" in canon 7. This unnecessary confusion can be eliminated easily. The canons (that is, the general concept stated as a canon) can be eliminated from the Code, substituting one or two words indicating the scope of the particular chapter. For example, canon 2 can become chapter 2, Availability of Legal Services; and canon 4 can become chapter 4, Confidences. That minor change will make it difficult to misuse a "canon" or chapter heading.

Paradoxically, the Code is at once too complex and too simplistic. Despite the Code's complexity, most difficulties encountered in the use of the Code are attributable to provisions that all too often create a false sense of simplicity by ignoring complicating factors. Examples abound; a few will be mentioned.

The disciplinary rules were intended to be just that: regulatory rules to be enforced in disciplinary proceedings. The Preliminary Statement of the Code tells us, "The Disciplinary Rules state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action." The Preliminary Statement did not say—and hindsight indicates it should have said—that the disciplinary

37. See G. HAZARD, *supra* note 10, at 19.

38. This is the main reason for eliminating canon 9 and moving its worthwhile provisions to other parts of the Code.

rules are not to be used as procedural rules in civil or criminal cases. Because of this oversight, many courts have used disciplinary rules as though they were procedural rules. This misuse, or unintended use, has occurred in situations in which the disciplinary rules are ill-suited for use as procedural rules. Thus, courts have permitted advocates to use DR 5-101(B) and DR 5-102 to disqualify the opposing party's counsel.³⁹ That result was never intended; on the contrary, those disciplinary rules were intended to protect a client from overreaching by his own lawyer who might be willing to lessen his value to his client in order to obtain or continue employment in litigation. Most questions arising under those two disciplinary rules involve an issue of fact on whether a client will suffer substantial hardship if his lawyer, who is likely to be called as a witness, does not serve also as counsel. That fact issue should be resolved only in a disciplinary proceeding brought when there is reasonable cause for charging that the lawyer did not serve his client's best interests by being both witness and advocate. That fact issue will be resolved in a bungling fashion if—as has been done—a court permits *A* (in a lawsuit between *A* and *B*) to argue that *B*'s attorney should be disqualified because he is improperly serving *B* by acting both as witness and as advocate.⁴⁰ The presiding trial judge would better serve the system by following the advice found in *United States v. Gallagher*⁴¹: "When a district judge believes that a violation of the Code of Professional Responsibility may have occurred, he should, at a proper time, bring such matter to the attention of the appropriate disciplinary body."

Similarly, many courts have, in effect, converted DR 5-105 into a procedural rule used to disqualify lawyers in "conflict of interest" situations. These courts have failed to recognize that DR 5-105 was designed for use as a regulatory rule in disciplinary matters, not as a procedural rule governing disqualification of lawyers in civil litigation. Indeed, DR 5-105 does not work well as a procedural rule, and a properly worded procedural rule of disqualification probably would contain provisions differing substantially from those of DR 5-105. A concise

39. See generally *J.P. Foley & Co. v. Vanderbilt*, 523 F.2d 1357 (2d Cir. 1975); *Kroungold v. Triester*, 521 F.2d 763 (3d Cir. 1975).

40. As suggested in dissent in *Comden v. Superior Court*, 20 Cal. 3d 906, 919, 576 P.2d 971, 978, 145 Cal. Rptr. 9, 16, cert. denied, 99 S. Ct. 568 (1978) (dissenting opinion), the disciplinary rules are not rules of practice, and to disqualify a lawyer for the other party on the basis of DR 5-101 and DR 5-102 is not preserving the integrity of the attorney-client relationship but is destroying it, and the problems involved in enforcement of DR 5-101 and DR 5-102 should be left to the disciplinary authorities.

41. 576 F.2d 1028, 1039 n.8 (3d Cir. 1978).

statement in the Code that disciplinary rules are to be used as regulatory rules and not as procedural rules should put an end to much existing confusion.

The ethical considerations give a false sense of simplicity because their three distinct functions are not clearly delineated in the Code. The ethical considerations are in part commentary on the black-letter disciplinary rules, giving guidance to interpretation and application of the disciplinary rules in much the same way that the "Comments" in the Restatements give insight to the black-letter law. The ethical considerations also state some ethical norms of aspirations; it is this function that is described in the Code's Preliminary Statement. The third function performed by the ethical considerations—and performed lifelessly—is that of stating the standards of normal professional practices of the legal profession. If the drafters of the Code had had in mind more clearly the three discrete functions served by the ethical considerations and if they had not blended the three together in an indistinguishable (and perhaps undistinguished) mass, the standards of normal professional practices would have been stated more completely and clearly. Much of the criticism of the Code would not have occurred, for much criticism has stemmed from this deficiency in the ethical considerations.

A false sense of simplicity also results from the many specific provisions of the Code that appear, at first blush, to be sufficiently detailed when, in fact, they are not. An illustration is the recurring use in the disciplinary rules of the concept, "consent of his client after full disclosure." Full disclosure of what? Is a knowledgeable, intelligent consent required, or only a formal consent? Is consent of the client as much of a cure-all as the Code seems to indicate? For example, may consent of a governmental unit be obtained to cure any impropriety in the representation by a lawyer of the governmental unit and another whose interests differ from the interests of the governmental unit? The question whether a standard of conduct should be less onerous when the lawyer obtains "consent of his client after full disclosure" is much more complicated than the Code suggests.⁴²

CONCLUSION

It is time to revise the Code, for a large number of its standards should be reevaluated. Many should be modified, amplified, or aban-

42. See generally Gibson, *supra* note 5.

done. The revised Code should contain all three kinds of standards: regulatory laws, standards of recommended normal professional practices, and ethical norms of aspirations and professional objectives. The disciplinary standards should be realistic and susceptible of uniform, regular enforcement. The standards of recommended normal professional practices should be informative and should supply as much guidance as possible. The specific ethical considerations and disciplinary rules that have been mentioned herein are only some of the standards that are candidates for revision, for it is time to restudy the entire Code with revision in mind. The ABA's Special Committee on Evaluation of Professional Standards' assignment to reevaluate the Code is therefore timely. That committee's careful, scholarly and thoughtful reconsideration of all the standards now contained in the Code is sure to produce wise and useful solutions for a host of problems currently encountered in the interpretation of the Code and in the application of the disciplinary rules.

A PRELIMINARY RATIONALIZATION OF THE LAW OF LEGAL ETHICS

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rationalize, v.t. 1. To give a rational or rationalistic explanation of;
as: *a* To make conformable to principles satisfactory to reason
.....¹

The American Bar Association's Canons of Professional Ethics of 1908, and its successor, the Code of Professional Responsibility, adopted in 1969, present a jurisprudential problem of more than passing interest that has received less than concentrated attention. Are the rules they embody rules of ethics or rules of law? Perhaps the absence of commentary on this question has to do with the difficulty of distinguishing law and ethics in relation to the lawyer's conduct, a difficulty made more acute by the common law characteristic of making law after the fact: what was perceived as an ethical rule becomes a legal rule by decision of the court, at least for the case decided. The concern here, however, is not with any one rule, but with a body of rules, and the problem of characterization is simplified if we treat it as essentially one of perception. As the lawyer perceives them, the profession's rules of conduct are a matter of ethics rather than law, a perception that is not wholly without its advantages to members of the bar: ethical rules are only commendatory in nature, whereas legal rules are mandatory.

The difference takes on particular importance in an adversary system of law administration, for in terms of the lawyer's traditional learning, the adversary system requires loyalty to the client above all else:²

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1. WEBSTER'S COLLEGIATE DICTIONARY (5th ed. 1941).

2. Lord Brougham's famous speech in defense of Queen Caroline before the House of Lords is perhaps the best known statement of the lawyer's duty of loyalty to the client.

[A]n advocate, by the sacred duty which he owes his client, knows in the discharge of that office but one person in the world, that client and none other. To save that client by all expedient means, to protect that client at all hazards and costs, to all others, and among others to himself, is the highest and most unquestioned of his duties; and he must not regard the alarm, the suffering, the torment, the destruction which he may bring upon any other.

what the lawyer can do for the client that is not unlawful is ethical, and sometimes, it has been argued, even the unlawful is ethical.³ So the profession's bias is for viewing the rules as ethical, a bias generally shared, at least in the past, by judges who tended to view the Canons as ethical rules.⁴ That courts tend to view the disciplinary rules as legal rules in those states in which the Code has been adopted⁵ does not solve the ethical-legal problem for the federal courts,⁶ nor does it necessarily alter the lawyer's view. Indeed, the Code functions much the

W. FORSYTH, *HORTENSIVS THE ADVOCATE* 380 (Jersey City, N.J. 1822). In fact, the statement was a political threat rather than a statement of the advocate's duty. As Lord Brougham explained it, "The real truth is, that the statement was anything rather than a deliberate and well-considered opinion, it was a menace, and it was addressed chiefly to George IV, but also to wiser men, such as Castlereagh and Wellington." *Id.* n.1 (quoting letter from Lord Brougham to W. Forsyth (1859)).

Loyalty to the client, however, may not have always had the preeminence it has had in the last century.

I want to suggest that by the 1870's leading American lawyers were coming to espouse a responsibility to their clients as their primary and even exclusive moral obligation as lawyers. There is reason to accept Mark DeWolfe Howe's thesis that the professional loyalties of lawyers after the Civil War moved from "parties and their principles" to "clients and their interests."

Schudson, *Public, Private, and Professional Lives: The Correspondence of David Dudley Field and Samuel Bowles*, 21 AM. J. LEGAL HIST. 191, 193 (1977) (footnote omitted). See Howe, Book Review, 60 HARV. L. REV. 838 (1947) (reviewing 1 R. SWAIN, *THE CRAVATH FIRM AND ITS PREDECESSORS*, 1819-1947 (1946)).

3. See Curtis, *The Ethics of Advocacy*, 4 STAN. L. REV. 3 (1951); Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469, 1474 (1966).

4. "The Canons of Ethics of the State and American Bar Associations are not binding obligations and are not enforced by courts as such; however, they constitute a safe guide for professional conduct and an attorney may be disciplined for not observing them." *In re Heirich*, 10 Ill. 2d 357, 386-87, 140 N.E.2d 825, 839-40, cert. denied, 355 U.S. 805 (1957). See also *In re Krasner*, 32 Ill. 2d 121, 204 N.E.2d 10 (1965). As Drinker said, "While it is clear that a lawyer may be disciplined for violating a Canon which forbids something not otherwise proscribed, the court decisions are not entirely clear as to the legal effect of a lawyer's violation of such a Canon." H. DRINKER, *LEGAL ETHICS* 26 (1953).

5. The disciplinary rules of the Code, having been adopted pursuant to a statutory power, have the force and effect of a statute; and conduct of any attorney licensed by this court to practice law in this state may be subject to discipline if his conduct falls below the standards contained in these rules.

State v. Alvey, 215 Kan. 460, 464, 524 P.2d 747, 751 (1974); cf. *Krahmer v. McClafferty*, 282 A.2d 631, 633 (Del. Super. Ct. 1971) ("The duty and obligation of a lawyer under the Canons of Professional Ethics supercedes any requirement of a City Charter such as we have here which would seem to require that he or a member of his staff represent even though there might be a conflict of interest involved."). See also *Andresen v. Bar Ass'n*, 269 Md. App. 313, 305 A.2d 845 (1973).

6. Federal courts appear to use the Code as a source of law rather than as law per se. "[T]here exists no statutory obligation upon the federal courts to apply the Code as enacted by any state jurisdiction or as adopted by the American Bar Association." *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1351 (D. Colo. 1976). "The law [on disqualification] in this Circuit is, of course, little more than a reinforcement of the Code of Professional Responsibility, ethical considerations, and disciplinary rules, promulgated by the American Bar Association and adopted by the Supreme Court of Louisiana effective July 1, 1970." *Wilson P. Abraham Constr. Corp. v. Armco Steel Corp.*, 559 F.2d 250, 252 (5th Cir. 1977). "The

same as the old Canons of Professional Ethics for lawyers. Despite the mandatory "shall" in the disciplinary rules, attorneys by and large still view the Code primarily as a matter of ethics, a not unreasonable view since two of its three parts, the canons and the ethical considerations, are clearly stated as ethical rather than legal precepts. The view is further substantiated by the Code's lack of sanctions for violating a disciplinary rule, and also because it explicitly eschews the idea that the rules are standards for determining the civil liability of lawyers.⁷

History and tradition support the lawyer's view that the profession's rules are ethical in nature—more than commendatory, perhaps, but less than mandatory. The Canons of 1908 prescribed rules of propriety, largely reflecting, it seems, the naive notion that precatory rules can serve as effective guidelines to ensure moral conduct. But it would be surprising had it been otherwise, since the antecedents of the Canons were, for the most part, moral, if not moralistic, in tone, exhorting the lawyer to do good.⁸ In addition to the profession's rules of conduct, however, there is a large body of similar rules in the form of positive law,⁹ and the question is whether the profession's rules should be

Code is recognized by both state and federal courts within this circuit as providing appropriate guidelines for proper professional behavior." *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 567 F.2d 225, 227 n.2 (2d Cir. 1977). See also *Halverson v. Convenient Food Mart, Inc.*, 458 F.2d 927 (7th Cir. 1972).

7. "The Code makes no attempt to prescribe either disciplinary procedures or penalties for violation of a Disciplinary Rule, nor does it undertake to define standards for civil liability of lawyers for professional conduct." ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement.

8. See Armstrong, *A Century of Legal Ethics*, 64 A.B.A.J. 1063 (1978) (reviewing history of statements of standards of conduct for lawyers). The first formal statement was 2 D. HOFFMAN, *Resolutions in Regard to Professional Deportment*, in A COURSE OF LEGAL STUDY 752 (2d ed. 1836) (1st ed. Baltimore 1817). The second statement was G. SHARSWOOD, *ESSAY ON PROFESSIONAL ETHICS* (Philadelphia 1854). Both of these documents formed the basis for the Code of Ethics of the Alabama State Bar Association, written by Thomas Goode Jones, and adopted in 1887, 118 Ala. XXIII-XXXIV (1899), which in turn served as the basis for the ABA CANONS OF PROFESSIONAL ETHICS, adopted in 1908.

9. State statutes regulating bar membership often contain provisions relating to professional conduct. See, e.g., ILL. ANN. STAT. ch. 13, §§ 21 (prohibiting barratry), 22 (prohibiting maintenance) (Smith-Hurd Supp. 1978). Rules of practice and procedure also often contain rules of conduct. The Indiana statute is perhaps the most comprehensive on the duties of lawyers. It provides:

It shall be the duty of an attorney:

First. To support the Constitution and laws of the United States and of this state.

Second. To maintain the respect that is due to the courts of justice and judicial officers.

Third. To counsel or maintain such actions, proceedings or defenses only, as appear to him legal and just; but this section shall not be construed to prevent the defense of a person charged with crime, in any case.

Fourth. To employ for the purpose of maintaining the causes confided to him, such means, only, as are consistent with truth, and never seek to mislead the court or jury by any artifice or false statement of fact or law.

treated as having the force of such law.

There is a hidden issue here—the lawyer's ability to determine the appropriateness of his own conduct in a given situation. To treat ethical rules of conduct as legal rules denies him the choice the former gives, and so constitutes a threat to his exercise of discretion and hence to his independence and authority. The lawyer's concern for preserving these qualities is consistent with history, for the tradition of the independent lawyer responsible only to the client reflects the larger traditions of the dignity of the individual and of individual rights that loom so large in the reservoir of general ideas that underlie our legal heritage. Thus, even when his effort conflicts with the larger concerns of the law, ethical rules enjoin the lawyer to give the individual every benefit of doubt. The lesson of the Code is that to err in favor of the client is the lesser evil.¹⁰

The paradox is that to give the lawyer discretion to be ethical through the medium of ethics is also to give him the discretion to be unethical. Thus, unless we correlate rules of ethical and legal conduct for the lawyer, the result will often be less than either.¹¹ Yet a common justification for retaining ethical rules is that they provide a maximal level of conduct, while legal rules provide only the minimal level of

Fifth. To maintain inviolate the confidence, and, at every peril to himself, to preserve the secrets of his client.

Sixth. To abstain from all offensive personality, and to advance no fact prejudicial to the honor or reputation of a party or witness, unless required by the justice of the cause with which he is charged.

Seventh. Not to encourage either the commencement or the continuance of an action or proceeding from any motive of passion or interest.

Eighth. Never to reject, from any consideration personal to himself, the cause of the defenseless or oppressed.

Ninth. To promptly account to and pay over [to] a client any moneys coming into the hands of the attorney and to which the client is lawfully entitled.

Tenth. To abstain from direct or indirect solicitation of employment to institute, prosecute, or defend against any claim, action or cause of action.

IND. CODE ANN. § 34-1-60-4 (1971).

A federal statute provides for payment of excess costs when an attorney or other person "multiplies the proceedings in any case as to increase costs unreasonably and vexatiously." 28 U.S.C. § 1927 (1970). A similar statute in Illinois provides also for the payment of attorney's fees. ILL. ANN. STAT. ch. 110, § 41 (Smith-Hurd Supp. 1978).

10. "While serving as advocate, a lawyer should resolve in favor of his client doubts as to the bounds of the law." EC 7-3.

11. "Compliance or noncompliance with Canons of Ethics frequently do not involve morality or venality, but differences of opinion among honest men over the ethical propriety of conduct." *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 567 F.2d 225, 227 (2d Cir. 1977). *See, e.g., In re Ryder*, 263 F. Supp. 360 (E.D. Va.), *aff'd*, 381 F.2d 713 (4th Cir. 1967) (former Assistant United States Attorney representing client accused of bank robbery sought, and followed, advice on disposition of stolen money and sawed-off shotgun given him by client; lawyer was suspended from practice for 18 months).

conduct, a point manifested by the aspirational nature of the ethical considerations in the Code.¹² If minimal and maximal rules of conduct are in fact appropriate for the lawyer, the justification has some merit, despite its self-serving character. But the premise is subject to considerable question. Competence is competence whether commended by an ethical rule or commanded by a legal rule, and the factors that result, for example, in a conflict of interest do not change with the efficacy of the rule proscribing it.

Beyond this truism, two bodies of rules, one ethical and one legal, are likely to be competitive rather than complementary, at least so long as there are bad as well as good lawyers. Such competition creates a hidden cost, for it means that the price of a separate body of ethical rules is both opportunity for the cynical and confusion for the conscientious lawyer. To command with one rule what is merely commended by another frequently gives a choice, whether intended or not, and the effect is to detract from the efficacy of the legal rule.¹³ The advantage goes to the unethical lawyer, since the ambiguity created thereby gives an opportunity to apply the ethical or legal rule as expedience dictates. The point is best illustrated, perhaps, by the rules regarding the lawyer's duty to maintain the confidences of the client. Thus, DR 4-101(C) states, "A lawyer *may* reveal: . . . (2) confidences or secrets when permitted under Disciplinary Rules or required by law or court order"¹⁴ As ABA Opinion 341¹⁵ makes clear, the option to reveal or

12. "The Ethical Considerations are aspirational in character and represent objectives toward which every member of the profession should strive." ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement.

13. Compare DR 4-101(C) (providing that

[a] lawyer may reveal:

- (1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.
- (2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.
- (3) The intention of his client to commit a crime and the information necessary to prevent the crime.
- (4) Confidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct),

with EC 4-2 ("The obligation to protect confidences and secrets obviously does not preclude a lawyer from revealing information when his client consents after full disclosure, when necessary to perform professional employment, when permitted by a Disciplinary Rule, or when required by law."). The ethical consideration seems to give the lawyer discretion to keep the client's confidences even when the law requires him to reveal it.

14. DR 4-101(C) (emphasis added).

15. ABA COMM. ON PROFESSIONAL ETHICS, RECENT ETHICS OPINIONS, No. 341 (Sept. 30, 1975).

not is that of the lawyer, surely an unwarranted assumption of authority in the face of what the law requires. Even so, the risk of discipline in such a case is minimal, for discretionary ethical rules create doubt that enables reasonable men to disagree, and the disagreement is usually sufficient to preclude the imposition of sanctions.

The vice of rules of conduct as ethical rather than legal, however, goes even deeper. For as they create opportunity for the cynical lawyer, enabling him to do what the law prohibits, they create dilemmas for the conscientious lawyer, providing him with a rationale for not doing what the law permits or requires. The Code of Professional Responsibility, for example, tells us, "A lawyer shall not intentionally: (1) Fail to seek the lawful objectives of his client through reasonably available means permitted by law."¹⁶ Yet, "In his representation of a client, a lawyer may: (1) Where permissible, exercise his professional judgment to waive or fail to assert a right or position of his client."¹⁷ The application of these rules to the problem of taking a default judgment against a party represented by a lawyer demonstrates the dilemma. Is this a legal or an ethical problem? The rules on default judgments are based on the duty of a party to respond to the court's processes, and the failure to respond gives the plaintiff the legal right to judgment. The failure in this case, however, is that of the lawyer, and the intuitive feeling is that the defendant should not be compelled to pay for his lawyer's sins. As an ethical matter, the judgment should not be taken, but to preclude this action as a matter of law, we need a legal duty for the plaintiff's lawyer as justification. We find that duty, ultimately, in a principle of fairness. Once this principle is recognized, a rule emerges: The plaintiff's lawyer should not take the default judgment without notice to his fellow lawyer.¹⁸ The duty of fairness imposed by this rule, however, must be legal rather than merely ethical in nature to justify what would otherwise be the lawyer's failure to represent his client with zeal.¹⁹

16. DR 7-101(A).

17. DR 7-101(B)(1).

18. This is the position taken in the Code of Trial Conduct of the American College of Trial Lawyers: "When [a lawyer] knows the identity of a lawyer representing an opposing party, he should not take advantage of the lawyer by causing any default or dismissal to be entered without first inquiring about the opposing lawyer's intention to proceed." AMERICAN COLLEGE OF TRIAL LAWYERS, CODE OF TRIAL CONDUCT No. 14(a) (rev. ed. 1972).

19. As an ethical rule, the rule is merely a rule of etiquette. In *Cook v. Aurora Motors, Inc.*, 503 P.2d 1046 (Alas. 1972), the lawyer filed a motion to dismiss an appeal for noncompliance with the court rule requiring a concise statement of the grounds of appeal exactly 30 days after the judgment without ever contacting opposing counsel. The court approved the provisions of rule 14(a), AMERICAN COLLEGE OF TRIAL LAWYERS, *supra* note 18, saying: "This practice is a highly

But even this does not reach the real issue. Most of the disciplinary rules in the Code reflect positive rules of law. Why should two rules of substantially the same content create confusion for the conscientious and opportunity for the cynical? The answer seems to lie in the defects of the Code, which result because its rules are not properly derived from appropriate principles. For present purposes, a principle can be defined as a general rule, adopted or professed as a guide to action, that serves as a source for particular rules of conduct. Loyalty to the client is such a principle. In the legal context, the necessary standard of conduct generates the principle: The lawyer represents a client in resolving legal issues in an adversary system, the resolution of which requires, for example, competence and the avoidance of conflicts of interest. From this, it follows that the client has a right that the lawyer be competent and that he avoid conflicts of interest, which, of course, are his correlative duties to the client. Thus, the principles imply the rules, and the rules state the rights and duties.

This point takes us to the two defects of the Code. The first is that its disciplinary rules are derived from ethical rather than legal principles. The point is not as paradoxical as it sounds. Most rules of law start with felt notions of right and wrong and so have an ethical basis. And most rules of law are derived ultimately from ethical principles. But before an ethical principle can serve as a satisfactory source for legal rules, it must be accepted as a *legal* principle. To attempt to derive legal rules from ethical principles, as has been done in the Code, is to undermine the efficacy of the rules since the principle can be used to avoid application of the rule.²⁰

This last point is related to the even more serious second fault,

desired courtesy to the opposing side, which can help avoid unnecessary, time-consuming motions before the court." 503 P.2d at 1049 n.6. Conduct that results in "unnecessary, time-consuming motions" involves more than a matter of courtesy. Cf. ABA CANONS OF PROFESSIONAL ETHICS No. 25 ("Taking Technical Advantage of Opposite Counsel; Agreements with Him").

20. This is most likely to occur with the ethical principle of loyalty to the client. Thus, canon 7 of the Code states: "A Lawyer Should Represent A Client Zealously Within The Bounds Of The Law." The lawyer can use the duty to represent a client with zeal as an excuse for avoiding the rules requiring that his representation be within the bounds of the law in DR 7-102. One of the problems is the uncertain bounds of the law. DR 7-102(A)(3) says a lawyer shall not "conceal or knowingly fail to disclose that which he is required by law to reveal." Is a lawyer required to reveal that plaintiff has sued the right defendant under the wrong name, naming an unincorporated business as a corporation, if he files an answer to the complaint and defends the case? In *Halloran v. Blue & White Liberty Cab Co.*, 253 Minn. 436, 92 N.W.2d 794 (1958), the lawyer did not reveal his client's (plaintiff's) mistake in this regard. The case resulted in a \$1,000 judgment and was before the municipal court of Minneapolis four times and the Minnesota Supreme Court twice, an unconscionable situation sanctioned by the ethical duty of loyalty to the client.

which is that in the Code of Professional Responsibility only one principle has been articulated—the principle of loyalty to the client. This point has been obscured because of the confusion in the Code about principles and rules. Three of the four main canons, 4, 5 and 6, having to do with confidentiality, conflicts of interest and competence, purport to be principles, but they are in fact merely different aspects of the principle of loyalty to the client. The three canons, in short, are rules disguised as principles, for each is necessary to implement the principle of loyalty, which is inartfully stated in canon 7 as the duty to represent the client zealously within the bounds of the law. As the language of the canon makes clear, the principle of loyalty to the client is not, and cannot be, absolute. Yet, the Code contains no countervailing principles and the result is that the principle of loyalty is counterbalanced only by mitigating rules. There is, for example, no canon in the Code stating a principle of candor to the tribunal or a principle of fairness to others. The mitigating rules requiring that a lawyer be candid with the court or that a lawyer be fair to an opponent are overwhelmed by the principle of loyalty to the client, to whom the lawyer looks for his fee.

The purported limitation contained in the statement of the principle—that the client is to be represented within the bounds of the law—does not do the job, for the principle of loyalty to the client is too powerful. The lawyer who does not reveal his client's fraud on the court in violation of a rule, for example, can always plead loyalty to the client in defense. And, indeed, he will have good company in doing so, for even the prestigious Legal Ethics Committee of the American Bar Association has wavered on the issue.²¹ The confusion in the Committee's opinions points up the problem. The rule requiring the lawyer to reveal to the court a client's fraud on the court, DR 7-102(B), can properly be derived only from a principle relating to the court. Yet, in the Code, the rule purports to be in implementation of the principle relating only to the client. Logically, the construction of canon 7 has the defect that a dangling participle has in grammar.

The major reason for the Code's defects seems to be the failure to

21. Compare the following opinions of the ABA Committee on Legal Ethics: ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 23 (1967) ("An attorney for a fugitive from justice should not disclose the fugitive's hiding place to the prosecuting authorities when he learns of it from information given to him by relatives."); *id.* No. 155 ("An attorney, whose client has fled the jurisdiction of the court while out on bail, must reveal the whereabouts of his client even if received in confidence from the client."); *id.* No. 287 ("An attorney who secured a divorce for a client should not reveal the truth to the court when the client informs him that he committed perjury in securing the divorce.").

recognize the function of rules of conduct for lawyers, which is to define more precisely the nature of rights and duties stated only generally in rules of positive law. Another reason is the failure to acknowledge the role of principles in our law. Legal principles underlie all rules of law, but the doctrine of *stare decisis* tends to obscure their importance. Precedent makes similar facts fungible, and the lawyer wants the rule of a case in point in order to persuade the court. The problem is that the infinitude of facts tends to limit the usefulness of precedent, and inevitably sound legal reasoning requires a return to principles and the justifications for them, which is the point we are approaching with legal ethics. One reason we have not reached it is that it is not at all clear why lawyers as lawyers should have duties that are different from the duties of all others in the application of the law. The justification is that lawyers assume special, as opposed to general, duties²² when they choose to be lawyers.

General duties, the simplest example of which are the duties not to rob, rape or plunder, are applicable to all. Special duties are those duties that are applicable only to certain persons who by reason of their conduct have chosen to assume them. Marriage imposes special duties on the spouses; the acceptance of an official position imposes special duties on the officeholder, as does the acceptance of a license to practice medicine by a physician. The lawyer, then, assumes special duties because he or she is a lawyer, that is, a person authorized by the state to administer law on behalf of individual citizens. The basic duty is to uphold the law, and the lawyer fulfills this duty by fulfilling his duty to the client whom he represents, to the tribunal whose procedures he invokes on behalf of the client, and to the opposing parties against whom he acts for the client in accordance with the requirements of the law. The question is what should the law require of the lawyer? It is a question with which the profession has not quite come to grips, because lawyers have not yet fully accepted the fact that the lawyer's oath imposes upon him or her the primary responsibility for making the system of law administration function properly.²³

It is because the lawyer voluntarily assumes these obligations that

22. For a discussion on general and special duties, see Hart, *Are There Any Natural Rights?*, 64 *PHILOSOPHICAL REV.* 175, 183-88 (1955).

23. The lawyer stands in a unique position in our society . . . "An attorney does not hold an office or public trust, in the constitutional or statutory sense of that term, but is an officer of the court. He is, however, in a sense an officer of the state, with an obligation to the courts and to the public no less significant than his obligation to his clients. The office of attorney is indispensable to the administration of justice and is intimate and peculiar to its relation to, and vital well being of, the court."

the rules governing his or her conduct should be rules of law. Self-interest is too large an element of the adversary system to permit that system to be operated by lawyers guided by discretionary rather than mandatory rules. At the same time, there is no reason to suppose that making heretofore ethical rules mandatory would eliminate discretion, for the system must have some leeway, room for give and take. The rules of conduct must not constitute a strait jacket that would make the lawyer an agent of the state and thus do indirectly what the state cannot do directly—destroy the initiative of the individual. That the duties to the client, to the tribunal, and to opposing parties all differ in some measure, thus creating a healthy tension, is an antidote to this danger. But to make the antidote effective, the rules must be rational rules derived from principles of conduct that are conformable to reason and reflect ultimately the purpose of the legal system itself. Thus, it is necessary to rationalize the principles. We proceed to the task, first identifying the principles to be rationalized and then providing a preliminary rationalization for them.

I. THE PRINCIPLES OF CONDUCT

We begin with the question: What are the principles of conduct for the lawyer? An obvious, yet tentative answer is: Loyalty to the client, candor to the tribunal, and fairness to the opponent. The real question is whether the list is complete, that is, whether these three principles will serve as a sufficient source for rules to enable the lawyer to solve any, or almost any, ethical problem that may arise. Categorical answers to such broad questions are fraught with difficulties, but if we limit our concern to the lawyer as lawyer in an established lawyer-client relationship, the answer seems to be yes, a conclusion examined later. This qualification enables us to avoid the issues involved in legal services,²⁴ which is not to say that legal services is not an important

Sams v. Olah, 225 Ga. 497, 504, 169 S.E.2d 790, 798 (1969) (quoting 7 C.J.S.2d *Attorney & Client* § 4, at 706 (1962)).

24. The phrase "legal services" means different things to different people, but the problems under this heading are essentially administrative in nature, having to do with the delivery of legal services: providing legal services for the poor, group legal services, advertising, minimum fees, unauthorized practice, interstate practice, the representation of the unpopular client, and so forth. The issue in such matters is essentially to what extent shall the profession provide legal services, not the manner of providing them once the lawyer is employed. As the Supreme Court has made clear, the profession's power is limited in this regard. See, e.g., *Bates v. State Bar*, 433 U.S. 350 (1977); *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975); *NAACP v. Button*, 371 U.S. 415 (1963). The point, however, is not that the profession should not deal with such issues, but that

subject, but only that it extends beyond the present concern to broader issues.

The optimistic response to the qualified question rests on two foundations: reason and precedent. Reason tells us that principles of conduct for the lawyer have to do with duties and that duties result from relationships. The basic relationships of the lawyer are only three in number: with the client, with the tribunal, and with opposing parties. Ethical problems for the lawyer will arise with the client when he does not provide the client with good and faithful service, that is, fails in his duty of loyalty to the client; with the tribunal when he is not honest in his presentation to the tribunal, that is, fails in his duty of candor; and with the opposing party when he is overreaching in his tactics, that is, fails in his duty of fairness. The difficult question, reserved for later, is what do we mean by loyalty, by candor, and by fairness?

The second foundation of the conclusion, precedent, is found in the two most generally accepted statements of rules of conduct for lawyers: the ABA Canons of Professional Ethics of 1908 and the ABA Code of Professional Responsibility. Except for the rules dealing with legal services²⁵ and the rules of etiquette,²⁶ the Canons of Professional Ethics deal only with issues involving the three principles. An analysis of the Code of Professional Responsibility yields substantially the same results. Despite the lack of logical structure for both of these documents, the rules can be grouped under the three principles, dealing first with the duty of loyalty to the client, then candor to the tribunal, and, finally, fairness to the opponent.

The rules in the Canons of Professional Ethics on loyalty to the client treat four different aspects of the duty: competence, communication, conflicts of interest and confidences. Dealing with the issue of competence are canon 4 and canon 5, which require the lawyer to "exert his best efforts" in behalf of an indigent prisoner and "to present

the problems they represent are different in kind from the problems arising from an established lawyer-client relationship. A new code should thus have a separate part dealing with legal services.

25. Classification of such general rules as the canons will vary, but approximately 15 of the 47 canons dealt with what can be characterized as legal services, including: fees, ABA CANONS OF PROFESSIONAL ETHICS NOS. 12, 13, 14, 34, 38; advertising, *id.* Nos. 27, 43; right to decline clients, *id.* No. 31; specialization, *id.* Nos. 45, 46; partnership names, *id.* No. 33; expenses, *id.* No. 42; newspapers, *id.* No. 40; and aiding the unauthorized practice of law, *id.* No. 47.

26. Three of the canons are essentially rules of etiquette: "Ill-feeling and Personalities between Advocates," *id.* No. 17, "Punctuality and Expedition," *id.* No. 21, and "Attitude Toward Jury," *id.* No. 23.

every defense that the law of the land permits" in defense of a person accused of a crime. In terms of the importance of the duty, the rules are primitive, but their very existence, even for special situations, implies the existence of the duty generally, a point the Code affirms. Canon 6 of the Code states that "A Lawyer Should Represent A Client Competently" and implements the duty with two disciplinary rules.

The rules in the Canons deal with the duty of communication in almost as primitive a manner as with the duty of competence. But canon 8, "Advising Upon the Merits of a Client's Cause," does provide that the lawyer is "bound to give a candid opinion of the merits and probable result of pending or contemplated litigation," and canon 11, "Dealing With Trust Property," requires the lawyer to report and account to the client for such property. Canon 6 states the duty of the lawyer at the time of retainer "to disclose to the client all the circumstances . . . which might influence the client in the selection of counsel." But this duty is in conjunction with the duty to avoid conflicts of interest, and it is only in this respect that the Code deals with the duty of communication with the client at all. Thus, the Code provides that a lawyer may not accept employment if his professional judgment will or may be affected by his own financial, business, property or personal interests, "except with the consent of the client after full disclosure."²⁷

The Canons give the duty to avoid conflicts of interest more extensive treatment than either competence or communication receives. Although canon 6, "Adverse Influences and Conflicting Interests," does not treat the problem in a very helpful way, there are other canons directed to the same point: Canon 10 precludes a lawyer from purchasing an interest in litigation he is conducting; canon 35 precludes the use of intermediaries; and canon 38 provides that a lawyer should not accept compensation, commissions or rebates from others without the consent of the client after full disclosure. These three rules are directed to the basic problem of conflicts of interest, the exercise of independent judgment. In the Code, seven disciplinary rules implement the principle,²⁸ which is expressed in canon 5, "A Lawyer Should Exercise Independent Professional Judgment On Behalf Of A Client."

27. DR 5-101(A).

28. See DR 5-101 ("Refusing Employment When the Interests of the Lawyer May Impair His Independent Professional Judgment"); DR 5-102 ("Withdrawal as Counsel When the Lawyer Becomes a Witness"); DR 5-103 ("Avoiding Acquisition of Interests in Litigation"); DR 5-104 ("Limiting Business Relations with a Client"); DR 5-105 ("Refusing to Accept or Continue Employment if the Interests of Another Client May Impair the Independent Professional Judgment of the Lawyer"); DR 5-106 ("Settling Similar Claims of Clients"); DR 5-107 ("Avoiding Influence by Others Than the Client").

The matter of maintaining the confidences of a client is the subject of canon 37, which was amended in 1937 to make the duty more definitive. Thus, before the amendment, the canon began, "The duty to preserve his client's confidences outlasts the lawyer's employment" It was changed to read, "It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment" The Code treatment in canon 4, "A Lawyer Should Preserve The Confidences And Secrets Of A Client," is based on that of the Canons.

The second basic duty of the lawyer, candor to the tribunal, is combined in the Canons with the duty of fairness in canon 22, in which the duty of fairness receives more attention than the duty of candor, indicating that candor is only an aspect of fairness. But other canons also deal with candor. Canon 15, "How Far a Lawyer May Go in Supporting a Client's Cause," states that "[t]he office of attorney does not permit . . . any manner of fraud or chicane." Canon 3 precludes "marked attention and unusual hospitality on the part of a lawyer to a judge," and canon 26, "Professional Advocacy Other Than Before Courts," states that "[i]t is unprofessional conduct for a lawyer so engaged to conceal his attorneyship, or to employ secret solicitations, or to use means other than those addressed to the reason and understanding, to influence action." The Code, taking its cue from the Canons, also deals with candor in a tangential way, that is, in limitation of the duty of loyalty to the client and in relation to the duty of fairness. Thus, the duty of candor is not commanded per se, but is stated in terms of representing a client within the bounds of the law under canon 7, for the effect of DR 7-102(A) and (B), DR 7-106, DR 7-108 and DR 7-110 is to require candor from the lawyer in the situations specified.

The duty of fairness to an opponent is the subject of thirteen of the old canons, the largest number devoted to any subject except legal services. This is as it should be if the purpose of rules of conduct is to ensure fairness in the administration of the law; indeed, the surprising point is not their number, but that they are not always recognized as rules of fairness. Apart from canon 22, "Candor and Fairness," the Canons prohibit negotiation with the opposite party;²⁹ enjoin the lawyer to restrain the client from improprieties;³⁰ require fairness in the treatment of adverse witnesses and suitors;³¹ prohibit the lawyer from

29. ABA CANONS OF PROFESSIONAL ETHICS No. 9.

30. *Id.* No. 16.

31. *Id.* No. 18.

appearing as a witness for the client;³² prevent the lawyer from engaging in a newspaper discussion of pending litigation;³³ give the lawyer the right to control the incidents of the trial;³⁴ prohibit a lawyer from taking technical advantage of opposing counsel;³⁵ prohibit the lawyer from engaging in unjustifiable litigation;³⁶ preclude employment of a retired public official in connection with matters he dealt with while in office;³⁷ give the lawyer free access to witnesses of the opposing side;³⁸ and command the lawyer to rectify fraud or deception unjustly imposed upon the court or a party.³⁹

The Code's rules implementing the principle of fairness are similar to those in the Canons, but they are in a more structured context, for they are found in the disciplinary rules under canon 7, which states, "A Lawyer Should Represent A Client Zealously Within The Bounds Of The Law." This Canon is the Code's expression of the duty of loyalty, and the placing of the rules directed to fairness under it indicates that fairness to an opponent is in fact a limitation on the loyalty to the client. DR 7-101(B)(1), for example, gives the lawyer the right "to waive or fail to assert a right or position of the client," and DR 7-101(B)(2) gives a like privilege to "[r]efuse to aid or participate in conduct that he believes to be unlawful." Indeed, except for DR 7-101(A), all of the rules under canon 7 can be construed as being directed to the problem of fairness as indicated by their headings: "Representing a Client Within the Bounds of the Law";⁴⁰ "Performing the Duty of a Public Prosecutor or Other Government Lawyer";⁴¹ "Communicating With One of Adverse Interest";⁴² "Threatening Criminal Prosecution";⁴³ "Trial Publicity";⁴⁴ "Communication With or Investigation of Jurors";⁴⁵ "Contact With Witnesses";⁴⁶ and "Contact With Officials."⁴⁷

32. *Id.* No. 19.

33. *Id.* No. 20.

34. *Id.* No. 24.

35. *Id.* No. 25.

36. *Id.* No. 30.

37. *Id.* No. 36.

38. *Id.* No. 39.

39. *Id.* No. 41.

40. DR 7-102.

41. DR 7-103.

42. DR 7-104.

43. DR 7-105.

44. DR 7-107.

45. DR 7-108.

46. DR 7-109.

47. DR 7-110.

Although the rules can be placed under the three headings loyalty, candor and fairness, the classification in some cases may appear strained; this difficulty, however, arises more because of the way in which the rule is expressed than because of the problem to which the rule is directed. A rule prohibiting a lawyer from taking technical advantage of opposing counsel is clearly based on the concept of fairness; a rule regulating newspaper discussion of pending litigation is not so clearly based, but the purpose is to avoid prejudicial publicity, which may give one side an unfair advantage over the other. A rule giving the lawyer the right to control the incidents of a trial appears not to be germane to the problem of fairness until one realizes that one of its purposes is to provide the lawyer with the authority to resist the demands of an overreaching client. "In such matters no client has a right to demand that his counsel be illiberal, or that he do anything therein repugnant to his own sense of honor and propriety."⁴⁸

We return to the earlier question, whether the three principles, loyalty, candor and fairness, are sufficient sources for rules of conduct for the lawyer. All the issues dealt with in the Canons and the Code seem to be covered by these principles, yet there is room for doubt. This is partly because the Canons and Code give some of the issues only an inchoate treatment: for example, the duty of communication with the client. Primarily, however, because the principles for the rules have been neither articulated nor rationalized, there is no unity, and without unity, the logic escapes the reader. The result is a complete lack of structure in the Canons and an underdeveloped structure in the Code.

The point is not so much a criticism of the draftsmen as it is a recognition of the way principles develop. They do not emerge full blown and Athena-like from the brow of a Zeus. They evolve in a much more human-like fashion, emerging at first in the form of rules directed to particular problems. Only after the accretion of enough rules to provide a sufficiently broad perspective of the problems do we have a large enough view to state the principles. In a sense, then, the principles are a product of rules, but once properly articulated and rationalized, principles assume the dominant role. They provide structure for the rules, give them both order and reason, and become the source for new rules to deal with new problems. The process requires time and experience, and often results in false starts and unsatisfactory statements of principles, with a concomitant confusion in the rules.

48. ABA CANONS OF PROFESSIONAL ETHICS No. 24.

Canon 7 of the Code is an example of the last point. It reads, "A Lawyer Should Represent A Client Zealously Within The Bounds Of The Law." As indicated earlier, this is an inartful statement of the principle of loyalty to the client; in fact, the canon states two principles: loyalty to the client (represent a client zealously) and respect for the law (represent a client within the bounds of the law). But the term "law" is comprehensive, with the result that the disciplinary rules under the canon reflect all three principles of conduct: loyalty to the client, candor to the tribunal, and fairness to an opponent. Indeed, only DR 7-101 deals with loyalty to the client, for the remaining rules are concerned with keeping the lawyer within the bounds of the law.

The confused state of affairs is reflected partly in the content of the rules (they are not sharply focused), but primarily in their order and structure, a problem we can trace directly to the language of canon 7. To state a principle requiring a duty to a person (or legal entity) and in the same principle to attempt to limit that duty with the statement of a duty to an abstraction (the law) is to dilute the former and to diffuse the latter. Duties arise only out of relationships: one does not have a duty to "the law." The duty to stay within the bounds of the law is in fact a duty to others, for it is a duty to conduct oneself in relation to others in accordance with the requirements of the law. But if the others are not properly identified, there is no sound basis for the others to complain.

The Code, for example, deals with the problem of pleadings and motions in two rules: DR 7-102(A)(1), precluding a lawyer from filing a suit, asserting a position, conducting a defense, delaying a trial, or taking other action when the purpose is merely to harass or maliciously injure another, and DR 7-102(A)(2), prohibiting the lawyer from advancing a claim or defense that is unwarranted under existing law, except when such action "can be supported by good faith argument." The principle from which these rules purport to be derived relates only to the client, the rules being merely limitations on the duty of loyalty to the client rather than affirmative recognition of duties either to opposing parties or to the tribunal.

The central stumbling block to recognition and acknowledgment of these principles is that the focus has been on the lawyer as he relates to the client and to the law, and not on the lawyer as he relates to the legal system as it does, or should, function. The lawyer's conduct in relation to the tribunal and to opposing parties is no less important to the proper functioning of the legal system than his conduct in relation

to the client. Thus, the need is to rationalize the principles governing his conduct in all three relationships.

II. THE RATIONALIZATION OF THE PRINCIPLES

The principles must be rationalized in terms of the function of the legal system because their purpose is to provide direction in the administration of law. If they reflect the proper functioning of that system, they can provide for that system the necessary stability and flexibility; if principles are the source of stated rules for the ordinary situations, they can also be the source for creating rules to accommodate the unique situations. Thus, a knowledge of general principles helps the lawyer to serve the client in a way that particular rules often do not: they can be used to prevent the unjust operation of a rule in a given situation. This is because one can better determine whether a rule is being properly applied by understanding its purpose, which in turn one can more easily determine by reference to the principle from which it is derived.

There is one further point before we proceed to the task of justifying the three principles of conduct—loyalty to the client, candor to the tribunal, and fairness to the opponent. The terms in which these principles are couched vary in complexity. Loyalty is a complex concept that can have many different components, depending on the context. Loyalty to one's spouse requires different conduct than loyalty to one's employer. Candor is a simple concept without degrees of comparison. While a person may be more candid or less candid, in terms of the completeness of disclosure made, the result in respect of any particular fact is either candor or it is not. There may be disagreement on which facts one was or was not candid about, but with any given fact, one is not candid, more candid, or most candid, for an approximation of candor is not candor. Fairness is a pluralistic concept embracing many ideas rather than one, and is subjective in nature, for one's view of what is fair or unfair is determined by how he is affected.

With such disparate concepts, one cannot approach them in the same way. It would be fruitless, for example, to ask simply what is loyalty, what is candor, and what is fairness. Instead, questions that will yield helpful answers for the lawyer should be asked. They are: What conduct on the part of the lawyer constitutes loyalty? When in a proceeding is candor required? And what is a reasonably objective measure of fairness?

A. The Duty of Loyalty to the Client

The origin of the word loyalty is law, which makes it an appropriate notion to express the duty of fidelity to the client's interest: the ultimate function of the lawyer is to individualize the law for the client. The duty of loyalty is required by law,⁴⁹ and the legal command places it in the category of professional rather than personal loyalty, for the lawyer-client relationship exists not merely to serve the purposes of the individuals involved, but also to serve the ends of order and justice in an organized society.⁵⁰ The lawyer's duty of loyalty, thus, cannot be contrary to the principles of order or the requirements of justice, a point the Code makes by requiring that the lawyer's representation of a client be kept within the bounds of law, zealous though it may be. Even so, the lawyer often sees the injunction to remain within the law's limits as being mitigated, if not superceded, by the duty of zeal. What then is the justification for this duty of loyalty?

Most lawyers think of themselves only as advocates and of their function only as advocacy on behalf of the client, a perception that is surely too narrow in view of the conflicting considerations involved in the administration of law. The lawyer is a person licensed by the state to handle the affairs of another, and in doing so he fulfills several roles. He serves as an adviser, interpreting the meaning of the law; as an advocate in litigation; and as an agent in many capacities; as a private legislator in the drafting of a will, a trust instrument, a corporate indenture, or a simple contract; as a negotiator or mediator in reaching agreements and settling differences; or as an intermediary in securing a benefit from the government, such as welfare benefits, a building permit, a registration of securities, or the grant of a license for a television station. The task of the lawyer, in short, involves nothing less than the private administration of law: his ultimate function is to individualize

49. "The lawyer who does not represent his client with undivided loyalty is not ordinarily entitled to compensation for his services." *Rolfstad, Winkjer, Suess, McKennet & Kaiser, P.C. v. Hanson*, 221 N.W.2d 734, 737 (N.D. 1974). "The rules of law applicable to principal and agent control the relation between an attorney and his clients." *State v. Weinstein*, 411 S.W.2d 267, 272 (Mo. Ct. App. 1967).

50. One court noted:

A lawyer may not follow the directions of a client without first satisfying himself that the latter is seeking a legitimate and proper goal and intends to employ legal means to attain it. It is no excuse for an attorney to say that he only did what he did because directed to do so by his client. The propriety of any proposed course of action must be initially considered by the attorney, and it may be thereafter pursued only if the lawyer is completely satisfied that it involves no ethical compromise. It is for the lawyer, not the client, to make this decision.

In re Blatt, 65 N.J. 539, 545, 324 A.2d 15, 18 (1974).

the law for the client. Indeed, the lawyer's office can be characterized as a private administrative agency, and the fundamental role of the lawyer can be said to be that of administrator of law.

The state's function, on the other hand, is to provide people with the protection of law, for a primary purpose of law is to ensure order for society. To this end, law imposes restraints on the liberty of all individuals in the form of legal duties that give rise to legal rights in all individuals. But at any given time, the scope of a particular right or duty for a given individual may be uncertain. When a person faces an issue concerning his right or his duty, he may, if it is a simple one, resolve it himself, and in simple societies, the law of self-help usually governs. But ours is not a simple society, and the state that grants rights and imposes duties in the first place must provide a means for resolving the issues they create. Moreover, the means must be one that results in just resolutions, at least most of the time, for order in a free society requires justice. So the state licenses lawyers to serve the individual who seeks the protection of the law; it was not mere coincidence that before the legal profession fully developed, one who wanted a person to represent him in court in England had to obtain the permission of the king.⁵¹ Custom and convenience eventually dictated otherwise, so with the general privilege to represent came the obligation to represent well. We state this obligation in the form of the principle, loyalty to the client. This, then, is the justification for the duty of loyalty to the client. The lawyer, licensed by the state, is a private individual performing a public function, and in this role he assumes certain responsibilities of government, for he "is a part of the judicial system of the state."⁵² His duty is to provide protection of the law for his client, a duty best expressed, perhaps, in terms of the constitutional command of equal protection.

The command inevitably exceeds compliance, but that does not denigrate the goal. And if we accept the duty to provide protection of

51. "The power to appoint an attorney was a privilege to be conceded by royal grant; the appointment must be strictly proved; and in the royal courts an attorney must be appointed by the litigants in court." 2 W. HOLDSWORTH, *HISTORY OF ENGLISH LAW* 315-16 (3d ed. 1923). By the end of Elizabeth I's reign, apparently anyone could appoint an attorney without a special writ. *Id.* at 316-17; see Bellot, *The Origin of the Attorney-General*, 25 *LAW Q. REV.* 400 (1909).

52. *State v. Turner*, 217 Kan. 574, 581, 538 P.2d 966, 973 (1975) (citation omitted); cf. *State v. Jackson*, 162 Conn. 440, 449, 294 A.2d 517, 523 (1972) (quoting *In re Griffiths*, 162 Conn. 249, 256, 294 A.2d 281, 284 (1972), *rev'd on other grounds*, 413 U.S. 717 (1973)) ("Further, attorneys in Connecticut have interwoven dual functions as members of the Bar and as commissioners of the Superior Court, and 'are charged with using these powers and acting by the authority of the state in the interests of justice.'").

the law as the rationalization of the principle of loyalty to the client, the rules follow logically, for they have to do with the conduct necessary to implement the principle. What conduct constitutes loyalty in the context of our legal system is best viewed from the perspective of the client, albeit only the mythical reasonable client. We can assume that this client wants, and has a right to expect, the following: He wants the lawyer to be competent; he wants the lawyer to keep him informed; he wants the lawyer to represent his interest and not someone else's; and he wants the lawyer to keep information about his affairs in confidence. In short, the conduct necessary for the lawyer to fulfill the duty of loyalty has to do with competence, communication, avoiding conflicts of interest, and confidentiality. All of these elements of loyal conduct are covered in the Canons of Professional Ethics and the Code of Professional Responsibility. But, as we have seen, the treatment is disparate and uneven.

The principle of loyalty thus gives rise first to a rule imposing a duty of competence,⁵³ for the lawyer who is not competent cannot very well provide protection of the law for his client. And the fulfillment of the duty of competence to the client fulfills the lawyer's obligation to the state as well. The state's license to practice is an imprimatur of competence, and the quid pro quo is the proper administration of law by the lawyer in behalf of individual citizens. Thus, incompetence on the part of the lawyer, whether by negligence in preparation, ignorance of the law, or lack of zeal, can be viewed as a fraud on the state as well as on the client.⁵⁴

The justification of the duty of communication, that is, to be accountable to the client and to keep him informed, is in further implementation of the duty of loyalty. The lawyer is the agent and the client is the principal, but the functions of the lawyer make him a unique agent with an unusual power. Because clients are usually ignorant of the law and are under substantial stress, the lawyer has an unusual degree of control; indeed, he is frequently characterized as a fiduciary

53. "The client may be entitled to damages for losses resulting from his attorney's failure to exercise the degree of care, skill and diligence commonly exercised by reasonable and prudent lawyers within the State." *Rolfstad, Winkler, Suess, McKennett & Kaiser, P.C. v. Hanson*, 221 N.W.2d 734, 737 (N.D. 1974) (citing *Feil v. Wishek*, 193 N.W.2d 218 (N.D. 1971)).

54. Thus, courts may exercise summary jurisdiction over lawyers for misconduct. See *In re Sarelas*, 360 F. Supp. 794 (N.D. Ill. 1973), *aff'd mem.*, 497 F.2d 926 (7th Cir. 1974), in which the court, quoting *Ex parte Bradley*, 74 U.S. (7 Wall.) 364, 374 (1868), said: "'If guilty of fraud against their clients, or of stirring up litigation by corrupt devices, or using the forms of law to further the ends of injustice, . . . [lawyers] become subject to the summary jurisdiction of the court.'" 360 F. Supp. at 796.

in order to increase his accountability. The duty of communication with the client, then, is a means of ensuring that the lawyer will be responsible and responsive to the client. In one sense, it can be viewed as a device of quality or competence control, which serves to protect both the client and the lawyer. "It has long been an accepted rule of conduct that an attorney should be ready and willing to make full disclosure to his client at any time concerning his actions in the conduct of a case and all developments therein."⁵⁵

The duty to avoid conflicts of interest is, perhaps, the aspect of loyalty that is most susceptible to superficial justification. To say that no man can serve two masters will not suffice: the lawyer serves many masters in the form of many clients. The question is which aspect of the lawyer-client relationship creates the risks arising from conflicts of interest. Canon 5 of the Code, "A Lawyer Should Exercise Independent Judgment On Behalf Of A Client," gives a clue. The exercise of independent judgment requires that the lawyer's decisionmaking process not be polluted with factors detrimental to that process. Thus, the type of situation that gives rise to conflicts of interest is the dilemmatic situation in which irrelevant factors preclude proper decisionmaking in the interest of the client. The extreme example would be the advocate who attempts to represent both the plaintiff and the defendant in the same litigation. He cannot at the same time argue that plaintiff should win and defendant lose, and that defendant should win and plaintiff lose. The problem seldom exists in so stark a form, although it may, for example, when one lawyer seeks to represent both spouses in a divorce action.⁵⁶ More commonly, the problem exists in representing multiple plaintiffs or defendants, especially in criminal cases,⁵⁷ or in representing both parties to a business transaction.⁵⁸ And sometimes the problem involves the self-interest of the lawyer, as when a client wishes the lawyer to name himself as a legatee in the will the lawyer is preparing for the client.⁵⁹ The justification for rules requiring the lawyer to avoid

55. *In re Sullivan*, 494 S.W.2d 329 (Mo. 1973); see *People v. Forsyth*, 187 Colo. 438, 440, 534 P.2d 1210, 1211 (1975) ("[f]ailure to communicate with clients is not to be tolerated"); *Spindell v. State Bar*, 13 Cal. 3d 253, 530 P.2d 168, 178 Cal. Rptr. 480 (1975). See generally Annot., 80 A.L.R.3d 1240 (1977).

56. See, e.g., *Holmes v. Holmes*, 145 Ind. App. 52, 248 N.E.2d 564 (1969); *Halvorsen v. Halvorsen*, 3 Wash. App. 827, 479 P.2d 161 (1970).

57. See *Holloway v. Arkansas*, 435 U.S. 475 (1978); *In re Abrams*, 56 N.J. 271, 266 A.2d 275 (1970).

58. See *In re Kamp*, 40 N.J. 588, 194 A.2d 236 (1963); *Crest Inv. Trust, Inc. v. Comstock*, 23 Md. App. 280, 327 A.2d 891 (1974).

59. See *In re Estate of Smith*, 68 Wash. 2d 145, 411 P.2d 879, corrected, 68 Wash. 2d 903, 416 P.2d 124 (1966).

conflicts of interest, as these examples demonstrate, is to ensure, insofar as possible, integrity in the lawyer's decisionmaking process. This integrity is essential if the client is to receive protection of the law consistent with the lawyer's duty of loyalty.

The duty of confidentiality is a favorite of lawyers, and it is commonly justified on the ground that a client must be able to reveal all relevant information to the lawyer.⁶⁰ The justification is reasonable on its face and consistent with the lawyer's duty to provide protection of the law, but it is not sufficient. The client clearly has a right to give his lawyer all the information about his problem, but this right does not have as its correlative a duty on the part of the lawyer not to reveal the information. Correlative rights and duties must be related to the same subject, and the right of the client to reveal information to the lawyer has as its correlative the lawyer's duty to use the information in the representation of the client, which may, and usually does, require that he reveal it. Moreover, there may be instances in which the law requires the lawyer to reveal the information, for example when it is necessary to do so to prevent a crime. The lawyer's duty of confidentiality, in short, must also reflect the client's right to a properly functioning legal system. That right is to enable individuals to implement their legal rights and to fulfill their legal duties. The proper functioning of the legal system requires such interference with the individual's affairs as is consistent with its purpose. To the extent that information from and about the client is concerned, the interference is limited to information necessary and relevant to the issue involved, and the lawyer, as the client's agent, has a duty not to reveal more than the necessary and relevant information. In short, the client has a right of privacy, which is both consistent with, and characteristic of, one of the purposes of the legal system in a free society: to protect the dignity of the individual.

The rationalization of the lawyer's duty of loyalty, then, can be summarized as follows: The duty is justified with reference to the lawyer's function to provide the client with protection of the law. The performance of this function requires competence to be able to provide the protection; communication with the client to ensure responsibility and responsiveness to the client; the avoidance of conflicts of interest in order to maintain integrity in the lawyer's decisionmaking process; and the duty of confidentiality to protect the client's right of privacy.

60. *See Hangards, Inc. v. Johnson & Johnson*, 413 F. Supp. 926 (N.D. Cal. 1975).

B. The Duty of Candor to the Tribunal

Both in justification and in implementation, candor is the most subtle of the three principles of conduct. The recognition that truth is difficult to ascertain is a fundamental predicate of the adversary process. Like beauty in the eye of the beholder, truth is very much in the mind of the speaker. Thus, in the adversary system we emphasize candor as a means of finding the truth, and, indeed, often treat it as a synonym for truth, even though in fact it only implies sincerity. A candid person can, and often does, convey wrong information. The right to cross-examine witnesses, for example, is not predicated upon the premise that witnesses commit perjury—although they may—but that they may be mistaken. They may have perceived incorrectly, their memory may be faulty, their command of the language may be inadequate, or, of course, they may lie. So the proper functioning of the adversary trial does not depend so much upon truth as it does upon sincerity in the presentation of a case, for if there is sincerity the truth will most likely come out. The duty of candor, then, precludes the fabrication of either issues or evidence, and therein lies the reason the system requires candor: the lack of candor results in an obstruction of justice. The justification for the lawyer's duty is that he has willingly and voluntarily undertaken the responsibility for making the system work by becoming a member of the bar.

A major difficulty in developing rules to implement the principle of candor is that candor is subjective; we can measure it only against "the truth" that eventually comes out, often from many sources. We can infer that a person is not being candid if we know the fact about which he is speaking or if his story is internally inconsistent, but we cannot *know* that he is being dishonest. The duty of candor to the tribunal thus has been one of the most difficult both to articulate and to apply.

A more serious difficulty in developing rules of candor is the apparent dilemma the duty poses for the lawyer. As an advocate in the courtroom, the lawyer wants to present only such information, and in such a way, that will benefit his client; the judge, in contrast, simply wants accurate and complete information. The lawyer may violate his duty of loyalty to the client if he presents accurate information, and he may violate his duty of candor to the tribunal if he does not. There is something wrong here, and it is the assumption that the lawyer's duty of candor is an independent duty that arises simply from his relationship to the tribunal, apart from the duty of loyalty to the client. If the

assumption were right, it would mean that the lawyer has two different duties relating to the same subject (information presented) to two different persons (the client and the judge). The reason the assumption is not right is that the duty of candor is, in fact, a derivative duty, predicated not upon the lawyer's duty, but upon the duty of the client to the tribunal. The point has been obscured because we tend to think only in terms of the lawyer's, not the client's, relationship to the tribunal. Yet, the crucial relationship is that of the client.

It is the tribunal, not the lawyer, that renders the judgment for or against the client as litigant. The rights of the client under the law thus are ultimately against the tribunal, which has correlative duties to him. The lawyer's role, then, can best be described as an instrumental one, for he is an agent of both the client and the tribunal.⁶¹ This is the crucial point, for it means that his duties to both the client as litigant and to the tribunal must be consistent. Thus, the lawyer's rights and duties as advocate were all instrumental in nature, being derived from the client's rights and duties in one instance and from the tribunal's rights and duties in the other.

Because the lawyer is the principal actor in the courtroom, this point is less than obvious. We tend to say, for example, that the lawyer has a right to cross-examine witnesses against his client. This is correct, but it is only a derivative right in furtherance of the client's primary right. And the correlative duty to this primary right is in the tribunal. If the lawyer, for example, chooses not to cross-examine for reasons of tactics, there is no error for appeal. If the judge denies the opportunity for cross-examination, there is error, but because of harm to the client, not to the lawyer. Similarly, if the lawyer wishes to present immaterial evidence, he is denied the opportunity to do so because the client has no right that such evidence be presented. As one court stated: "He [the lawyer] does not represent himself as an individual. He is in the proceeding as the representative and alter-ego of his clients. His acts and appearances are those of his clients and are regarded as having been done by, and binding on, the clients."⁶²

Ultimately, then, the lawyer's rights and duties as advocate must be determined by the rights and duties of the client and of the tribunal,

61. "'A dual trust is imposed on attorneys at law. They must act with fidelity both to the courts and to their clients.'" *State v. Jackson*, 162 Conn. 440, 449, 294 A.2d 517, 523 (1972) (quoting *State Bar Ass'n v. Connecticut Bank & Trust Co.*, 145 Conn. 222, 234, 140 A.2d 863, 870 (1958)).

62. *State v. Weinstein*, 411 S.W.2d 267, 272 (Mo. Ct. App. 1967).

which can be ascertained only by the law governing the situation. A major problem is that the law is not always clear, and, indeed, at times is in conflict. So long as the law is ambiguous concerning the client's rights or duties, the advocate will, and should, act according to the interpretation most favorable to his client. But any confusion results from the ambiguity of the positive law stating the rights and duties of the client, not from any conflict in the duties of loyalty and candor, a point that emphasizes the need to integrate rules of conduct and positive law.⁶³

Another reason that development of rules concerning the duty of candor has been inadequate is that attention has been concentrated almost wholly on the communication of the witness rather than on the communication of the lawyer with the tribunal. And there has also been a failure to acknowledge that candor in litigation is a complex legal concept. We gain a better perspective, first, if we step back and recognize that candor is a quality of communication, and that the primary problem is the communication of the lawyer, not the witness, with the court; and second, if we recognize that what constitutes candor in a trial is determined by rules of law as well as by the facts.

The lawyer's communication with the court takes four different forms: pleadings, motions, examination of witnesses and argument. Pleadings are, perhaps, the most important communication of the lawyer, for they are the basis for motions, for the examination of witnesses, and for argument. The problem here is that there are offensive and defensive pleadings, which differ in purpose and function. The complaint states the grounds for relief and sets the machinery in motion; the answer is the defendant's response and serves to create the issues to be tried. Thus, the defendant who is clearly liable may properly deny liability, because he is not liable until the plaintiff has convinced the trier that this should be so. The answer, in short, is a procedural device and not a statement that necessarily reflects the facts, although when it purports to do so, it should do so accurately.

Motions, too, differ in purpose and function. They may be based

63. The common law rule, for example, is that illegally obtained evidence is admissible in civil cases. Thus, evidence obtained by illegal forcible entry has been held admissible in a divorce action in one jurisdiction, *Sackler v. Sackler*, 15 N.Y.2d 40, 255 N.Y.S.2d 83, 203 N.E.2d 481 (1964), but inadmissible in another, *Del Presto v. Del Presto*, 92 N.J. Super. 305, 223 A.2d 217 (1966). Cf. *Bruske v. Arnold*, 100 Ill. App. 2d 428, 241 N.E.2d 191 (1968), *aff'd*, 44 Ill. 2d 132, 254 N.E.2d 453, *cert. denied*, 398 U.S. 905 (1970) (holding the trial court properly suppressed evidence obtained in violation of legal ethics). On appeal, the court affirmed, acknowledging (but rejecting) the common law rule, and characterized the evidence as "illegally obtained." 44 Ill. 2d 132, 135, 254 N.E.2d 453, 455, *cert. denied*, 398 U.S. 905 (1970).

on information already before the tribunal and serve as procedural devices to protect the record, as with a motion for a directed verdict, or to dispose of issues as a matter of law, as with a motion to dismiss. Or they may be based upon information presented as true and accurate for the court's disposition without submitting the case to a jury, as with a motion for summary judgment.

The examination of witnesses presents the most complex problems because the lawyer communicates with the court through a third party and is limited by rules of evidence to ensure that the trier will get, as near as possible, an accurate picture of what happened. The requirements that the witness speak only of matters of which he has direct knowledge (except for the ubiquitous exceptions to the hearsay rule) and that he be subject to cross-examination serve to promote this goal.

The last form of communication to the court is argument, which may be on a point of law to persuade the judge to rule in one's favor, or which may be on the evidence to persuade the trier of fact. The common characteristic is that both kinds of arguments, as does all argument, consist of inferences. The difference is that argument based on law usually consists of direct inferences, the source of which—the case or statute—is available to all participants. The question may take one of two forms: What *does* the law require? Or what *should* the law require? Both are legitimate, and both are usually present. With either question, however, all relevant law should be before the court, and this explains why candor in the citation of authority has long been required.⁶⁴

Argument to persuade the trier of fact based on the evidence is usually a matter of indirect inferences, which consist of two kinds: inferences on the credibility of the witnesses; and, once the credibility has been accepted, inferences to determine the conclusion to which the evidence is directed. The goal of the lawyer is to persuade, a goal that is often sought through appeal to emotion rather than to intellect. The problem with such a subjective process is how to implement a duty of candor, a point to which we return later.

Implicit in all of these communications is the point that what constitutes candor in the trial of a case is a matter of law as well as fact. The complaint cannot merely state facts; it must state facts upon which the law will grant relief. The answer, except when it includes affirmative defenses, need not reflect the facts accurately, for that is not its

64 ABA CANONS OF PROFESSIONAL ETHICS No. 22, DR 7-106(B)(1).

purpose. Motions may fall into either category, for they may be based on either facts or law. Argument, by its nature, is subject to general, but not specific, limitations. But the requirement for all of these communications is relevance, and the point is that the rules of law determine the relevance of candor for the particular communication.

Rules relating to the lawyer's duty of candor thus must take into account three important factors: the duty of candor is a derivative duty, determined by the rights and duties of the client and of the tribunal; there are four types of communication with the tribunal; and candor to the tribunal is a matter of law and fact. From these factors, the principle of candor emerges: The lawyer shall have a reasonable basis in law and fact for communication with the tribunal. The problem is to develop the rules to implement the principle.

The rules evolve naturally to deal with pleadings, motions, evidence, and argument, and, in fact, they already exist in the law governing the conduct of litigation. The difficulty is that this law states the rights and duties of litigants in only a general way, and the natural tendency of the lawyer is to maximize the rights and minimize the duties of the client. The right to file a lawsuit is predicated on the existence of injury resulting from another's wrong, but does a client have a right to file a strike suit to force a settlement when no wrong has occurred? Obviously the answer is no, but to state this limitation in the rule would be to pose too great a threat to the right to file lawsuits generally. After all, the very purpose of the lawsuit is to determine if a wrong was committed. This is where the law of legal ethics comes in. The lawyer's job as advocate is to secure the client's rights, but it is a job to be performed with judgment and discretion in accordance with what those rights are. The law of legal ethics serves to define the rights and duties of the client more precisely and thereby to provide the lawyer with more effective guidelines for the exercise of sound discretion.

Consider, for example, the matter of pleadings. A client does not have a right to file a lawsuit unless there is a reasonable basis in fact and law for doing so. Thus, in complaints, the lawyer has the responsibility to see to it that the complaint presents only accurate facts as best he can ascertain them, based on a legal right as best he can determine under the law. In short, he must be completely candid. But an answer requires a lesser measure of candor, for the defendant has no choice but to respond, and the answer is essentially a procedural device for forming the issues. If the answer presents an affirmative defense, the measure of candor applicable to the complaint applies.

Motions are subject also to varying measures of candor. Some of them do not involve an issue of candor—for example, the motion for a directed verdict at the close of the opponent's case. A motion to dismiss involves only a question of law. But a motion for summary judgment is proper only if the facts as completely and accurately presented show that there is no issue of fact. On the other hand, in ruling on an *ex parte* motion, the judge depends wholly on one side's presentation of the facts, which requires complete candor by the party making the motion.

The presentation of evidence creates the most difficult problems of candor, for the lawyer's communication with the court in presenting testimony is through another. Does the lawyer have a responsibility for the candor of the witnesses he presents? The answer must be yes, for two reasons: first, the lawyer has a duty to make an independent determination of the accuracy of the witness' information; second, the lawyer determines by his questions what information the witness has the opportunity to present. Thus, to say that the lawyer has no responsibility for the candor of the witness is to suggest that a lawyer has no responsibility to the tribunal and that his role as an officer of the court must be relegated to the realm of fiction.

The point is clear regarding the examination of one's own witnesses, but it is also relevant to the cross-examination of opposing witnesses. Insincerity in the cross-examination of the opposing witnesses constitutes as much an abrogation of the duty of candor on the part of the lawyer as the subornation of perjury by one's own witnesses. The object is the same: to misinform the trier of fact. To test the witness' perception, memory, language or sincerity is one thing; to attempt to trick and browbeat him is another.

The more difficult problem for the lawyer is the client witness who wishes to, or does, commit perjury, particularly when the client is a criminal defendant. As to the matter of the civil client who commits perjury, there can be little dispute if we are to maintain integrity in our system of trial. The problem of the accused's perjury is too complex to permit more than a few general observations here, but the basic issue is this: Does a person's accusal of a crime give him a right to commit perjury? The question is made more complex than it deserves to be because of other legal rights of the accused: the right to a lawyer, the right to testify, the right to be sworn as a witness, the right against self-incrimination, and so forth. Can a lawyer provide effective representation for an accused if he has a duty to inform the court of his client's

perjury? The lawyer for the accused will vigorously assert that he cannot, and that, indeed, such a duty would violate the client's privilege against self-incrimination. The reason is simple: most persons tried for a criminal offense in fact committed the act for which they are being tried.⁶⁵ And a person who insists on being tried for the offense with which he is charged and which he committed cannot reasonably be expected to get on the witness stand and admit that he did the act. So the question comes down to this: Does our sense of fair play require that an accused be given an opportunity to deny his guilt regardless of the facts? Courts, not bar committees, will answer this question.⁶⁶

The purpose of argument is to persuade, which often means that it is directed more to emotion than reason. The lawyer has a right, and a duty, to urge upon the trier of fact both the credibility of his witnesses and any reasonable inference that can be drawn from the evidence. But he does not have a right to seek to persuade the trier to believe the perjurious witness or to use perjured evidence as a basis of decision. Thus it is important to state a duty of candor in regard to argument. But here we must make some concession to the subjective nature of argument. The lawyer must have broad latitude within certain limits. The problem is to define the limits, and we define these limits in terms of relevancy. What type of inference is clearly irrelevant to the decision of the case? The obvious answer is bogus inferences, which may be of two types: those without any basis in the evidence, which can be easily determined; and those directed to the irrational prejudices of the trier—racial, ethnic, class, religious or provincial. To the extent it can preclude such inferences, the duty of candor has a real function in regard to argument, and the difficulty of implementing the rules should not prevent their promulgation.

This brings us to the reason for articulating rules relating to the four aspects of the lawyer's communication with the tribunal. The duty is comprehensive, and candor at a later stage may depend upon candor at an earlier stage. Lack of candor in the complaint requires a lack of

65. See *Lakeside v. Oregon*, 435 U.S. 333, 342 (1978) (Stevens, J., dissenting). The conclusion is not based on empirical data, but if it is not true, something is sadly wrong with the many safeguards in the system to ensure that it is true—police investigations, probable cause, the grand jury, preliminary hearings, and so forth. The "presumption of innocence" that militates against accepting the proposition is a procedural device to require the prosecutor to prove guilt. This is not to say that innocent persons are not indicted, but they have every reason to testify in their own defense.

66. See, e.g., *Lowery v. Cardwell*, 575 F.2d 727 (9th Cir. 1978); Lefstein, *The Criminal Defendant Who Proposes Perjury: Re-thinking the Defense Lawyer's Dilemma*, 6 HOFSTRA L. REV. 665 (1978).

candor in making motions, in presenting evidence and in argument. On the other hand, candor in the complaint does not necessarily preclude lack of candor at a later stage. Indeed, to state a rule of candor for the presentation of evidence and to ignore pleadings, motions and argument is to imply the lack of a duty of candor in regard to conduct involving these aspects of communication with the tribunal. And to state the rule only in general terms—in the form of a principle—does not provide the lawyer with meaningful guidelines.

That the lack of candor to the tribunal constitutes an obstruction to justice is the justification for the duty of candor to the tribunal. The problem with accepting this justification may be that lawyers are not concerned so much with justice as they are with winning. At least this must be so for half the lawyers in any trial, a point that helps to explain the attraction of the adversary system. To lawyers, it is a means of winning a case. But if that system is to survive, lawyers (and clients) must recognize that the adversary system is only a means of presenting a case, and when they do not present the case with candor, they distort the system.

C. The Duty of Fairness to Opposing Parties

The duty of fairness to opposing parties may well be the most complex of the lawyer's fundamental duties because our system of law administration is a competitive one. Moreover, contrary to the common notion, the competitive aspects of the adversary system are not limited to the judicial process, for inevitably the characteristics of litigation in the judicial process are carried over into the administrative, legislative and private legal processes. So the continuing problem in an adversary system of law administration is fairness.

The essence of the adversary system, however, is not that it is competitive, but that it is a legal system which seeks to ensure equal rights for all. Every person in our society has the same rights as every other person, and it is this fundamental fact that is the basis for justifying the lawyer's duty of fairness. If all persons have equal rights, they are entitled to equal treatment under the law in accordance with their legal rights and duties. Lawyers, as administrators of law, determine to a large extent whether persons do receive this equal treatment. In dealing with opposing parties, for example, the lawyer seeks to impose legal duties on them. Because our legal system provides that persons can be compelled to perform their legal duties only in a manner consistent with the requirements of law, any person against whom the lawyer acts

has a right that the lawyer comply with the requirements of the law. The notion is most succinctly expressed in the phrase "due process," often considered applicable only to the government. But due process is applicable whenever the exercise of legal power is involved, and by analogy it extends to the function of the lawyer in the form of private due process. The right of all persons to due process, both public and private, is thus the justification for the lawyer's duty of fairness.

The more difficult problem is implementing the duty, because it is necessary to determine the measure of fairness. Perhaps because the concept is so broad that in the abstract it is meaningless, we are uncomfortable in dealing with fairness alone and usually treat it in terms of specific duties arising out of particular relationships. Loyalty to the client and candor to the tribunal, for example, are but particular applications of the concept of fairness. The lawyer who fails in his duty of competence, communication, confidence, or avoiding conflicts of interest is being unfair to the client, even though we do not find it necessary to resort to the higher level of abstraction in order to be able to provide a remedy. The wrong committed has more specific bases, which we find in the common interest shared as a result of the relationship. The lawyer who fails in his duty of candor to the tribunal is being unfair to the opposing party as well as to the tribunal, a point we overlook because the duty is directed to the tribunal. This duty is imposed because of the importance of the lawyer's role in the administration of justice, but unlike the lawyer's relationship with the client, the lawyer's relationship with the tribunal is not one of a completely shared community of interest.

The problem with a duty of fairness to opposing parties is that there is no shared community of interest, which is another way of saying that we do not recognize the existence of a legal relationship between, for example, plaintiff and defendant, as we do between lawyer and client and between lawyer and tribunal. Thus, there seems to be no basis upon which to impose a duty of fairness directly. At present we do it indirectly by requiring that the lawyer be candid with the tribunal. Yet, it may be done directly, for if we define a legal relationship as one in which the parties have legal rights and legal duties vis-à-vis each other, it is clear that opposing parties do have a legal relationship. The plaintiff has a legal right, for example, that defendant respond to proper service of process, and the defendant has a duty to do so.

We perceive, therefore, a two-track legal relationship, one to the opposing party, and one to the tribunal. The disadvantage in this view

is that if we fulfill one of the duties, we feel free to ignore the other. Even worse, if we breach the duty to one and receive no sanctions, we feel free to ignore the duty to the other. Specifically, if the tribunal does not respond negatively to misinformation the lawyer presents, he or she will feel no duty to the opposing party to correct the information. And, of course, the tribunal ordinarily will have no way of knowing when misinformation is presented.

Yet because of the competitive nature of the adversary process, we do not acknowledge the legal relationship between opposing parties, and therefore do not recognize the legal rights and duties that they have in relation to each other. And until we recognize the nature of this relationship, we will continue to attempt to deal with the issue of fairness indirectly rather than directly. Lawyers will continue to view the adversary litigation primarily as a means of winning a case when in truth it is also and more fundamentally a means of fairly presenting a case.

Even if we recognize the legal relationship between opposing parties, there remains the matter of how to measure fairness. On this point, it is helpful to return to the particular applications of fairness, loyalty to the client and candor to the tribunal. In these cases, the existence of a legal relationship is manifest, and it is apparent that the measure of the lawyer's conduct is the rights and duties of the client. Once we accept the legal relationship between opposing parties, the same measure becomes applicable in the context of the relationship to opposing parties as is applicable in the different contexts of the relationships to client and tribunal. And although different applications of the fairness principle result in these divergent contexts, the common thread is that each is essentially the product of the reliance the client's rights and duties justify placing in the lawyer. Thus the client has a right to rely upon the lawyer's competence, communications, and so forth, because the lawyer assumes these obligations when he or she agrees to represent the client. In a similar way, the tribunal has a right to rely upon the lawyer's representations because the lawyer is an officer of the tribunal. The obligations a lawyer assumes in relation to opposing parties, however, are not so clear, and consequently it is more difficult to measure properly the reliance that an opposing party has a right to place in the lawyer's actions.

One's perception of what is fair is determined largely by self-interest, so there must be some reasonably objective standard. The issue is essentially the same as that in measuring the duty of loyalty to

the client and candor to the tribunal, and so the measure is the same: the legal rights and duties of the client. But it is clear that the duty of loyalty to the client and candor to the tribunal must encompass more than the duty of fairness to an opponent. How do we make the distinction in terms of the legal rights and duties of the client?

A first step is to recognize that there are two kinds of rights involved: substantive and procedural. It is through the exercise of procedural rights that we determine the applicability, in a given case, of substantive rights. Procedural rights, in other words, are instruments for determining substantive rights, and serve as the primary instrument for the lawyer in both protecting and implementing the substantive rights of his client. It is here, then, that the issue of fairness arises, for it is in the abuse of procedural rules that unfairness most often occurs. The rules of procedure for litigation serve to illustrate the point and aid in understanding why this is so.

Rules of procedures state general requirements for specific types of situations, the particulars of which are infinitely variable. Consequently, they are easily subject to manipulation by a skillful lawyer. If the rule requires an answer within thirty days, file the answer at closing time on the thirtieth day.⁶⁷ If the rule requires service of process within the jurisdiction, trick the defendant into coming into the jurisdiction.⁶⁸ If the plaintiff names the wrong defendant, file an equivocal answer and move to quash any judgment.⁶⁹ If the rule permits interrogatories, swamp the opponent with interrogatories. If the opponent has a limited budget, drown him with discovery depositions. And so on *ad infinitum* under the motto, "protract, prolong, and procrastinate."

A good lawyer, of course, does not usually engage in such tactics, and for good reason: they usually do not succeed, at least not if the issue is brought before the court.⁷⁰ That the court usually rejects them points up the question. If the lawyer complies with the requirements of the rule as stated—that is, files within thirty days, serves the defendant within the jurisdiction, follows the rules relating to interrogatories, and so forth—why are the results rejected? The answer, of course, is that he

67. See *Cook v. Aurora Motors, Inc.*, 503 P.2d 1046 (Alas. 1972), discussed in note 19 *supra*.

68. See *Tickle v. Barton*, 142 W. Va. 188, 95 S.E.2d 427 (1966).

69. See *Halloran v. Blue & White Liberty Cab Co.*, 253 Minn. 436, 92 N.W.2d 794 (1958), discussed in note 20 *supra*.

70. The tactics failed in cases cited notes 67-69 *supra*.

was not complying with the rules in terms of their purpose and function, as the opposing party has a right to expect him to do in accordance with a principle of fairness. He was not, in other words, exercising the legal rights of his client fairly.

When these problems are analyzed, then, it is apparent that the courts are concerned with a duty of fairness. The problem is how to make this duty apparent for the lawyer before he acts. There are two approaches, both of which are problematic. One is to recognize that any legal right contains an implied duty that it be exercised in accordance with its purpose and function, that is, an implied duty of fairness. The other is to define the legal right more precisely and to state the purpose and function as a part of the rule. Neither approach, however, is satisfactory from the standpoint of positive law. Apart from theoretical problems to which the first approach gives rise, to limit a legal right by an implied duty of fairness in its exercise constitutes a threat to its existence. The chilling effect can be difficult to counter. And to attempt to include in the statement of all rules their purpose and function is to assume an impossible task.

The problem is one for a law of legal ethics, for that law is a set of rules to govern the conduct of lawyers as they exercise and implement the legal rights of their clients, and these things that cannot be done in positive law can easily be done in the law of legal ethics. Thus, it is appropriate to recognize as a legal principle the lawyer's duty of fairness to opposing parties, a principle that will help to make clear that all legal rights contain an implied duty to exercise them in light of their purpose and function. And it is equally appropriate to state rules of conduct for the lawyer to implement the duty of fairness by defining the purpose and function of the procedural rules. This, in fact, is the approach attempted in the Code of Professional Responsibility in DR 7-102, "Representing a Client Within the Bounds of the Law." Thus, DR 7-102(A) provides:

In his representation of a client, a lawyer shall not: (1) File a suit, assert a position, conduct a defense, delay a trial, or take other action on behalf of his client when he knows or when it is obvious that such action would serve merely to harass or maliciously injure another.

The rule is a rule of fairness, which makes the point that the rights stated are to be exercised in light of their purpose and function. Unfortunately, the structure of the rule prevents the point from being clear, because it is stated negatively and treats the duty of fairness indirectly. The rule is both clearer and more explicit if it is read as follows: "A

lawyer shall file a suit, assert a position, conduct a defense, delay a trial, or take other action on behalf of his client only if there is a reasonable basis in law and fact for doing so, and shall not take such actions merely to harass or maliciously injure another." So stated, the rule constitutes an explicit recognition that there is a right to file a lawsuit only if there is reasonable basis for doing so. In similar manner, the law of legal ethics can articulate what the procedural rules only imply: The exercise of legal rights is limited by a duty of fairness.

The important point is that when a lawyer files a lawsuit merely to harass or injure another maliciously, he is not exercising a legal right, for the right does not extend so far. So it follows that in filing such a suit, he is infringing the rights of the defendant. It is the failure of courts (and lawyers) to recognize this point that enables lawyers to prevail so often on the basis of the form of the rule rather than its substance, as when a lawyer takes a default judgment against a party represented by a lawyer. But, of course, the law of legal ethics cannot fulfill the function of supplying a legal duty of fairness until the profession's rules of conduct are accepted as legal rather than ethical rules. We must, in short, fully recognize that standards for the lawyer are an integral part of the law and that law is an integral part of standards for the lawyer.

The law of legal ethics implementing the principle of fairness, then, need be little more than an annotation on the rules of procedure for litigation, broadened to encompass the rules of the lawyer other than as advocate. The Federal Rules of Civil Procedure, for example, represent a continuing effort in quest of fairness in the adversary system, the essence of which is reliance, that is, the absence of surprise or deception. Thus, a party should have notice of actions his opponent intends to take in the resolution of the dispute; a party should be able to rely upon the pleadings and motions of his opponent; and a party should have access to the information his opponent is relying upon. The federal rules fulfill all of these requirements. From the standpoint of the law of legal ethics, the most important of these rules is rule 11, requiring honesty in pleading:

The signature of an attorney constitutes a certificate by him that he has read the pleading; that to the best of his knowledge, information, and belief there is good ground to support it; and that it is not interposed for delay. . . . For a wilful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action

may be taken if scandalous or indecent matter is inserted.⁷¹

The rule demonstrates as well as any could that rules of law are an integral part of ethical standards, and that ethical standards are an integral part of the law.

Merely to annotate the rules of procedure, however, is not sufficient, for the duty of fairness to opposing parties is not limited to the courtroom. Nor does the absence of formal rules of procedure in non-litigation contexts deprive the lawyer of an effective guide to fairness, for all of the lawyer's work, in a sense, depends upon procedures, formal or informal. In the office no less than in the courtroom, a lawyer should have notice of actions opposing counsel intends to take in the resolution of a dispute; a lawyer should be able to rely upon the words of his counterpart; and a lawyer should have access to the relevant information his opponent is relying upon. The analogy, of course, is not exact. Negotiating a contract is not the same as trying a lawsuit. But the essentials of fairness—the absence of deception and the reliability of another's word—are relevant in all the lawyer's work.

The justification for the duty of fairness to opposing parties, then, is the right of all persons that legal duties be imposed upon them only in accordance with the requirements of law, the right of private due process. The measure of this duty of fairness we find in rules of procedure, both formal and informal, applied in light of their purpose and function.

III. CONCLUSION

We return to the question with which we began: Should the profession's rules of conduct be rules of ethics or rules of law? The argument for the latter alternative rests on the proposition that the three principles of conduct for the lawyer—loyalty to the client, candor to the tribunal, and fairness to opposing parties—state fundamental principles of law administration, for it is on these principles that the implementation of the rights and duties of the individual in our society and under our adversary legal system ultimately depend. Thus, the lawyer's duties of loyalty, of candor and of fairness should be recognized as being derived from legal, rather than merely ethical, principles, naturally giving rise to legal rules. To do otherwise is to create a continuing risk to the rule of law, for we thereby vest in private lawyers, who

71. FED. R. CIV. P. 11.

administer the law in the service of private (and paying) clients, a vast amount of untutored discretion.

The ultimate question is this: Are the profession's rules of conduct to enable the lawyer to aid the client in exercising nonexistent rights and in violating existing duties? The obvious answer is no, but how are the scope of the client's rights and the measure of his duties to be defined in order that these bounds are not overstepped? Lawyers cannot be expected to perform this task since between them the issues are matters of dispute, and properly so. Thus we come back to an earlier point: the function of the law of legal ethics is to define for the lawyer as precisely as possible the rights (and duties) of the client that he seeks to implement.

The point warrants further comment, even at the risk of repetition. A legal right is not a matter of degree but of kind: either one has a legal right or he does not; if he has it, he may exercise it. But the statement of a right does not always make clear the content of the right. Language has its limits, and the rule of law cannot cover all the factual situations to which the right it entails applies or ostensibly applies. Thus, I have a right to enter into a contract, but I do not have a right to enter into a fraudulent contract, one I have neither the intention nor the capability of performing. As a litigant, I have a right to testify, but not to commit perjury. As a businessman, I have a right to register an offering of stock with the SEC, but not to falsify my registration. As a citizen, I have a right to avoid, but not to evade, the payment of taxes.

The point is not always clear to the client. Even if he did induce a party into signing the document by fraudulent misrepresentations, he nevertheless has a contract. For the statement of a legal right *per se* is seldom sufficiently precise to negate conduct that appears to be the exercise of the right, but that in fact is the breach of a duty that is correlative to some other right held by someone else. The law of legal ethics thus can define more precisely for the lawyer the rights and duties of the client stated in general rules of law and thereby make explicit what the lawyer may and may not do in implementing those rights and duties for the client. This law does not simply reflect the positive law, but refines it as well, and so serves a function not dissimilar to that which equity served in relation to the old common law: as a body of rules complementary to, and not competitive with, the positive law, the law of legal ethics will help to provide flexibility in the administration of law and thus promote greater stability. With the law of legal ethics delineating rights more precisely, disagreements can be concentrated

more on the merits and less on the tactics in the resolution of legal disputes.

This has been the goal of rules of conduct for the lawyer since the adoption of the Alabama Code of Ethics in 1887. That it has not been fully achieved may be because the goal has something of the characteristics of the Holy Grail; still, the search is desirable. Three factors have impeded its success. The first is that the rules of conduct for the lawyer have been limited for the most part to the role of the lawyer as advocate. The reason for this, it seems, is that the law for the advocate, the rules of procedure, has been the most highly developed and clearly stated area of the law. Thus, it has been relatively easy to reflect and to refine that law in terms of rules of conduct for the lawyer. DR 7-102 of the Code of Professional Responsibility is the prime example. But it is difficult to find, for instance, statutory rules defining the role of the lawyer as adviser or agent, that is, as negotiator, mediator, private legislator, and so forth.

The second impediment is related to the first, for it is the failure to realize that the lawyer in the representation of a client exercises only the procedural rights of the client. Admittedly, the term procedural in this context must be given a broad, almost generic, meaning. But in drafting a contract, drawing up a will, applying for a license, and so forth, the lawyer must follow procedural rules no less important, even if they are less definitive and structured, than those he follows in trying a case. Perhaps the point becomes clearer when we recognize that lawyers *ex hypothesis* cannot exercise substantive rights of their clients; they can draft the legal document, but only the parties can execute the contract.

The procedural law for the lawyer as adviser and agent exists, some of it in statutes, but most of it in the cases. The problem is to extract this law and then to define the rights it entails in the law of legal ethics. The result will not be too much different from the procedural law for litigation, for the same fundamental principles apply whether the lawyer is acting as adviser, advocate or agent, and whether he does so in the administrative, the judicial, the legislative, or the private legal process. The principles are substantially the same, but the application of the principles, and the rules derived therefrom, will be different. The adversary trial in the courtroom involves considerations that are different from those involved in the negotiating session in the lawyer's office.

A third factor that has constituted an obstacle to the success of

rules of conduct for lawyers is more subtle and complex. Lawyers, no less than other people, tend to act as they are expected to act. This is important because lawyers have defined their own expectations, in the form of rules of ethics, as wishes rather than commands. Precatory rules are, of course, inordinately difficult to enforce, and so injunctions concerning ethical conduct for the most part remain fallow. Moreover, the lawyer who chooses to be unethical in his conduct finds protection not only in the ambiguity of precatory rules, but also in the cumbersome procedure for disciplining those who violate the rules. One can venture to guess that analysis will reveal that lawyers are disciplined not so much for conduct violating the Code of Professional Responsibility as for violating rules of positive law—fraud, perjury, theft, and so forth. And even then, the Code, with its emphasis on the duty of loyalty to the client, provides the basis for a defense that persuades even though it does not convince. Without principles of candor and fairness coequal with the principle of loyalty, it is exceedingly difficult to impose sanctions on the lawyer who acts under the umbrella of the latter.

The greatest problem, therefore, is not in black and white areas, but in the gray penumbra, the area of marginal competences, inadequate preparation, dilatory tactics, technical defenses, and resort to techniques such as the use of extensive discovery to beat down a poor opponent. Of such conduct judges are too often sympathetic, affected perhaps by remembrances of their own sometime failings at the bar; the need for precise and well-defined rules of conduct is not only for the guidance of the bar, but to aid the bench in giving this guidance the force of law.

So we conclude with these last few words: The basic principles of the lawyer's conduct—loyalty to the client, candor to the tribunal, and fairness to opposing parties—remind one of Holmes' aphorism that we need study of the obvious more than investigation of the obscure. Once we examine the basic relationships of the lawyer in terms of the function of the legal system the principles become obvious, for the adversary system of law is based on the premise of equal rights for all, to be administered primarily by private persons licensed by the state for that purpose.

The identification and rationalization of the principles of conduct for the lawyer, however, is only the beginning of the task, for to state them is one thing, to develop and apply them is another. As suggested above, the principles of conduct and the rules derived from them do not apply with equal force and in the same measure for the lawyer in

all his different roles, in all the legal processes, and for all clients. To understand why requires the development of the principles and rules of application, and that task is for another day.

COMPETITION AT THE BAR AND THE PROPOSED CODE OF PROFESSIONAL STANDARDS

STEPHEN K. HUBER†

The genesis of formal rules of professional behavior for lawyers in this country is Judge George Sharswood's *Essay on Professional Ethics*, published in 1854.¹ The principles set out therein were closely followed in a code of professional ethics adopted by the State Bar of Alabama, which in turn became the basis for the Canons of Professional Ethics promulgated in 1908 by the American Bar Association. The Canons, admittedly with some additions and amendments, survived for more than sixty years until superseded in 1969 by the Code of Professional Responsibility.² The Canons were thought to have been defective in four principal particulars:

(1) There are important areas involving the conduct of lawyers that are either only partially covered in or totally omitted from the Canons; (2) Many Canons that are sound in substance are in need of editorial revision; (3) Most of the Canons do not lend themselves to practical sanctions of violations; and (4) Changed and changing conditions in our legal system and urbanized society require new statements of professional principles.³

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1. G. SHARSWOOD, *ESSAY ON PROFESSIONAL ETHICS* (Philadelphia 1854). The essay was initially presented as a series of lectures at the University of Pennsylvania Law School. It still makes good reading according to a former chairman of the ABA Committee on Professional Ethics:

It is surprising how well Sharswood reads, even today. His division of the lawyer's duties into those which he owes his client, the public, the state, the court, and his professional brethren still has validity. The ethical principles he establishes are eternal and therefore just as pertinent today as they were more than a century ago. It is in their application to specific cases that the difficulties lie.

Armstrong, *A Century of Legal Ethics*, 64 A.B.A.J. 1063, 1063 (1978).

2. Both the Canons and the Code were adopted in every state, generally with few if any modifications. Three forms of adoption were utilized: by legislation, by a unified bar, or by order of the highest state court. The effect in each instance was the creation of rules of positive law for the violation of which lawyers could be punished.

3. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preface.

The Canons, including amendments, consisted of 47 serially numbered provisions. Sanctions

Five years were devoted to preparation of the Code.⁴ Less than a decade after completion it has proven to be so unworkable that, despite the adoption of several major amendments, the Code is being scrapped and will be replaced by a new document, the Code of Professional Standards.⁵ Why did the Code, a product of years of concerted effort by many diligent and able people, become outmoded so rapidly? This question requires careful consideration if the Standards are to have a longer and more useful existence than their predecessor.

This article will argue that one important reason the Code proved unserviceable is that it did not permit the delivery of legal services to be organized in an efficient and cost-minimizing manner. In recent years the Supreme Court of the United States has decided that a number of rules in codes of professional behavior served primarily to increase profits for members of those professions. Among those cases are some in which the Court has determined that competition in the delivery of legal services would serve the public better than government-imposed restraints. Making these determinations required the invalidation of state laws regulating economic behavior. The legal vehicles for reaching this result were the antitrust laws and the first amendment, rather than substantive due process, which had been utilized earlier in this century.⁶

Attention will first be addressed to four "group legal services" cases, which involved efforts by potential purchasers of legal services to obtain assistance on behalf of their members, and to several cases decided by the Court since 1975, which have permitted, if not mandated, substantial competitive activity among professionals, particularly lawyers. After considering these cases and some contemporaneous developments in the social organization of the practice of law, the discussion

ranged from a private reprimand to disbarment. The Code contains three types of provisions: canons, ethical considerations and disciplinary rules. The canons, of which there are nine, state axiomatic norms. They are too general to merit analysis, and will not receive further mention. Disciplinary Rules (DR) are mandatory in character, and punitive sanctions can be imposed for violations. Ethical Considerations (EC) are aspirational in character; adherence to them is recommended but not mandatory.

4. The House of Delegates of the ABA, at the behest of its then President, Lewis Powell, created a Special Committee on Ethical Standards at its annual meeting in August 1964. The Committee's work product was adopted in its final form by the House of Delegates in August 1969. ABA CODE OF PROFESSIONAL RESPONSIBILITY. Preface. Powell thought that the Canons "were in need of major revision, particularly with respect to the relationship between the press and the bar, the representation of unpopular causes, and grievance procedures." Seymour, *The First Century of the American Bar Association*, 64 A.B.A.J. 1038, 1049 (1978).

5. The ABA appointed a Special Committee on Evaluation of Professional Standards in late 1977 to draft a document to replace the Code.

6. See text accompanying notes 10-19 *infra*.

will turn to the Code of Professional Responsibility and an examination of existing Code provisions that regulate the economic behavior of lawyers. It will be recommended that these provisions should not be retained in the Standards. Rules that operate only to control economic aspects of the practice of law have no place in a body of rules for professional behavior, especially when they serve no purpose other than to limit affordable access to lawyers.

The Code and the Canons were designed for an idealized America that no longer exists. As early as 1934 Harlan Fiske Stone had observed that "[o]ur canons of ethics are for the most part generalizations designed for an earlier era."⁷ This statement is quoted in the preface to the Code, but is not reflected in its substantive provisions, which barely address the problem of getting attorneys and clients together at reasonable prices in a largely urban land. Karl Llewellyn described the problem in the following manner:

The canons of ethics on business-getting are still built in terms of a town of twenty-five thousand (or, much more dubiously, even fifty thousand) All the lawyers are known, and people who have legal work to do are moderately aware of it; and they have little difficulty in finding a lawyer of whose character, abilities, experience, yes, and fees, they can get some fair inkling ahead of time. . . . Turn these same canons loose on a great city, and the results are devastating in proportion to its size. . . . [T]he conditions of metropolitan legal business make it no simple thing to reach into the grab-bag and pull out a lawyer who is able, experienced in the case at hand, not too taken up with other matters, and also reasonable in fee.⁸

Rather than heeding these admonitions, the bar insisted that the Code follow the Canons in containing detailed provisions designed expressly to ensure that lawyers could not make their availability to and desire for clients known to the public. In addition to restrictions on competition among attorneys, participation by lay intermediaries in supplying legal services was prohibited. Bar associations exercised vigilance in protecting their turf from encroachment by outsiders. The definition of legal work was stated broadly to increase the scope of what constituted the unauthorized practice of law.

7. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 10 (1934).

8. Llewellyn, *The Bar's Troubles, and Poultices—And Cures?*, 5 LAW & CONTEMP. PROB. 104, 115-16 (1938).

I. THE MOVEMENT FROM PROTECTION TO COMPETITION

During the course of this century many job categories have become subject to occupational licensure. Although such licensing is always undertaken in the public interest, licensure requirements are almost universally imposed at the behest of the group to be regulated and not the public.⁹ Licensed groups adopt codes of ethics that restrict competition among insiders and prevent encroachment on the group's domain by outsiders. Although many licensed groups have adopted restrictive rules similar to those contained in the Canons and the Code, the Supreme Court has been particularly willing to invalidate rules of ethics for lawyers, perhaps because the justices are able to recognize more clearly in their own profession than in others that rules restricting competition serve largely the interests of the profession and only incidentally those of the public. Also, the legal profession has been more successful than other groups in its efforts to restrict competition, both among its members and by outsiders.

A. *Changes in Judicial Attitude*

Until early in this century courts severely circumscribed the scope of legislative attempts at economic regulation through the doctrine of substantive due process. The position that the Constitution gives preference to no particular economic principles did not gain complete ascendancy until the early 1930's, when the Supreme Court ruled that:

[A] state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose. . . . "Whether the free operation of the normal laws of competition is a wise and wholesome rule for trade and commerce is an economic question which the court need not consider or determine." . . . With the wisdom of the policy adopted . . . , the courts are both incompetent and unauthorized to deal.¹⁰

One consequence of the demise of substantive due process was that courts refused to evaluate anticompetitive rules of professional groups that succeeded in obtaining legislative approval. Justice Holmes' famous dissenting opinion in *Lochner v. New York*¹¹ was often

9. See generally M. FRIEDMAN, CAPITALISM AND FREEDOM 137-60 (1962); B. SHIMBERG, B. ESSER & D. KRUGER, OCCUPATIONAL LICENSING: PRACTICES AND POLICIES (1972).

10. *Nebbia v. New York*, 291 U.S. 502, 537 (1934) (quoting *Northern Sec. Co. v. United States*, 193 U.S. 197, 337 (1904)).

11. 198 U.S. 45 (1905). The *Lochner* case represented "the focal point in a judicial move to fasten on the country by constitutional exegesis unsanctioned by the Constitution a pattern of

quoted in upholding such provisions:

It is settled by various decisions of this court that state constitutions and state laws may regulate life in many ways which we as legislators might think of as injudicious or if you like as tyrannical The Fourteenth Amendment does not enact Mr. Herbert Spencer's Social Statics. . . . [A] constitution is not intended to embody a particular economic theory, whether of paternalism . . . or of *laissez faire*.¹²

Once this attitude was accepted, it is not surprising that the Supreme Court turned away a dentist's challenge to a state law that precluded him from engaging in truthful advertising.¹³ When the extensive regulations that Oklahoma imposed on the preparation and sale of eyeglasses were challenged, the Supreme Court upheld the legislation and accepted as a valid objective the state's attempt to remove from the eyeglass business "all *taints* of commercialism."¹⁴ If this policy was thought to be unwise and costly to consumers, the proper forum before which to raise the argument was the legislature.¹⁵ A challenge to a Kansas statute that permitted only lawyers to engage in the business of debt adjusting was turned away for the same reason.

Whether the legislature takes for its textbook Adam Smith, Herbert Spencer, Lord Keynes, or some other is no concern of ours. The Kansas debt adjusting statute may be wise or unwise. But relief, if any be needed, lies not with us but the body constituted to pass laws for the State of Kansas.¹⁶

In this legal climate the prevention of competition both among those in the profession and from outsiders becomes a major if unarticulated, objective of bar associations. Since the *raison d'être* for professional licensing and rules of ethics is protection of the public, the desire

economic organization believed by the Court to be essential to the fullest development of the nation's economy." Strong, *The Economic Philosophy of Lochner: Emergence, Embrace and Emasculation*, 15 ARIZ. L. REV. 419, 419 (1973).

12. 198 U.S. at 75 (dissenting opinion).

13. *Semler v. Oregon State Bd. of Dental Examiners*, 294 U.S. 608 (1935). "[T]he community is concerned in providing safeguards not only against deception, but against practices which would tend to demoralize the profession by forcing its members into an unseemly rivalry which would enlarge the opportunities of the least scrupulous." *Id.* at 612.

14. *Williamson v. Lee Optical Co.*, 348 U.S. 483, 491 (1955) (emphasis added).

15. The Court noted:

The Oklahoma law may exact a needless, wasteful requirement in many cases. But it is for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement. . . .

The day is gone when this Court uses the Due Process Clause of the Fourteenth Amendment to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought.

Id. at 487-88.

16. *Ferguson v. Skrupa*, 372 U.S. 726, 732 (1963) (footnotes omitted), *quoted with approval in North Dakota State Bd. of Pharmacy v. Snyder's Drug Stores, Inc.*, 414 U.S. 156, 165-66 (1973).

to limit competition was rarely admitted. An exception is illuminating. The Jacksonville, Florida, bar established a lawyer referral service in which all local attorneys were eligible to participate and then proceeded to advertise its existence. A challenge to this scheme, based on Canon 28, which condemned advertising, was rejected because the advertisement did not involve competition among members of the profession and so did not fit within the reason for the rule.¹⁷ The Florida Supreme Court noted: "Of course competition is at the root of abuses in advertising. . . . But the advertising before us represents the very antithesis of competition."¹⁸ When individual lawyers advertised, they competed with one another, but when the referral service was publicized, it created business for the whole profession, and so did not violate the Canons.

The legal bases for recent decisions mandating competition in the professions have been the antitrust laws and the first amendment, but the results have been the same as might have been achieved in earlier years through the substantive due process standard.¹⁹ The important question raised by these developments of the extent to which the judicial branch of government should defer to a legislative determination of the public interest will not be considered here.²⁰ The discussion that follows will focus on the impact of recent Supreme Court decisions on the organization of the practice of law. The doctrinal underpinnings

17. *Jacksonville Bar Ass'n v. Wilson*, 102 So. 2d 292 (Fla. 1958).

18. *Id.* at 295.

19. The use of the antitrust laws to invalidate state regulation of economic activity has been sharply criticized.

Although presumably disdainful of substantive due process, the federal courts have seized upon another approach to oversee state economic regulation. Increasingly the challenge to occupational licensing and price fixing by state regulatory bodies has come in the form of application of the antitrust laws to the offensive conduct. . . . [T]hose who oppose substantive economic review of state activity under the due process clause should doubt the advisability of engaging in antitrust review of that same activity, and for precisely the same reasons.

Verkuil, *State Action, Due Process and Antitrust: Reflections on Parker v. Brown*, 75 COLUM. L. REV. 328, 329-30 (1975).

20. Justice Rehnquist has argued, after the fashion of Justice Harlan before him, that the courts should defer to legislative judgments in the regulation of professions:

The Court speaks of the consumer's interest in the free flow of commercial information It goes on to observe that "society also may have a strong interest in the free flow of commercial information." One need not disagree with either of these statements in order to feel that they should presumptively be the concern of the Virginia Legislature, which sits to balance these and other claims [T]here is certainly nothing in the United States Constitution which requires the Virginia Legislature to hew to the teachings of Adam Smith in its legislative decisions

Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 783-84 (1976) (dissenting opinion).

offered by the Court in support of its decisions will receive only cursory analysis.

B. The Group Legal Services Cases

The Canons prohibited a lawyer from providing legal services to members of a group, though not to the group itself.²¹ The group was a "lay intermediary," and the evil involved was that the group came between the attorney and the client. This rule prohibited an automobile club from providing a lawyer for its members in traffic cases,²² a civil rights group from furnishing legal assistance in school desegregation cases,²³ and it even prevented a union from advising its members about what lawyer to retain in seeking compensation for job related injuries.²⁴ The wrong done by the lawyer depended on the manner in which he received payment. If the group reimbursed the lawyer for work done on behalf of its members, then the group was engaged in the unauthorized practice of law, and it was wrongful for the lawyer to assist the group in this illegal undertaking.²⁵ If the group acted only as a facilitator in bringing its members and the attorney together, with payment made by the client directly to the lawyer, then the evil involved was solicitation.

Until recently, groups have demonstrated little interest in providing legal services for their members on even a limited basis. A major reason is that early attempts to do so were vigorously and successfully opposed by bar associations. During the 1930's, a few automobile

21. ABA CANONS OF PROFESSIONAL ETHICS No. 35 provided:

The professional services of a lawyer should not be controlled or exploited by any lay agency, personal or corporate, which intervenes between client and lawyer. . . .

A lawyer may accept employment from any organization. . . to render legal services in any matter in which organization the organization, as an entity, is interested, but this employment should not include the rendering of legal services to the members of such an organization in respect to their individual affairs.

Charitable legal aid societies were exempted from these provisions, presumably because organizations that served only the indigent did not compete with private practitioners for clients.

In the group legal services cases, the Court decided that potential users of legal services cannot be precluded from acting in concert to obtain legal assistance. In *United Transp. Union v. State Bar*, 401 U.S. 576 (1971), Justice Harlan correctly observed that the issue was really an economic one and that these cases involved nothing more than "a combination of purchasers of services seeking to increase their market power." *Id.* at 599 (dissenting opinion).

22. *In re Maclub of America, Inc.*, 295 Mass. 45, 3 N.E.2d 272 (1936).

23. *See NAACP v. Button*, 371 U.S. 415 (1963).

24. *See Brotherhood of R.R. Trainmen v. Virginia State Bar*, 377 U.S. 1 (1964).

25. ABA CANONS OF PROFESSIONAL ETHICS No. 47; ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 3-101(A).

clubs attempted to provide their members with lawyers for certain situations related to the ownership and operation of automobiles, only to have this activity held to constitute the unauthorized practice of law.²⁶ At least one court saw precisely the "evil" that was involved: the club "deals at wholesale" in legal services.²⁷ In another case, a Missouri club, cognizant of the restrictions on the practice of law by automobile clubs, sought to appear in court on behalf of members who wanted a continuance or to plead guilty. The service provided by the club was purely one of convenience for its members, saving the time and trouble of a personal appearance and involving no discretion on the part of the court or the club representative. Even these ministerial activities were prohibited.²⁸

The existence and recent growth of group legal services are the result of four decisions from 1963 to 1971²⁹ in which the United States Supreme Court held that rules of professional ethics could not be used to prevent groups from recommending attorneys to their constituents or even from hiring salaried lawyers to represent their members. It is instructive to notice who the parties were in these suits. In three instances complaints were filed by bar associations,³⁰ and in the fourth case the suit was brought by the NAACP to restrain enforcement of a state bar-ratry statute.³¹ The legal services arrangements under attack were devised by a civil rights organization in one case and by labor unions in the others. That these groups represent people who have traditionally made minimal use of lawyers is not a coincidence. In each instance the alternative to representation through the group was no representation at all. Rules designed to protect the public were supported by the profession and used against the large majority of the public, which was (and still is) unserved by lawyers.³²

The resuscitation of the role of groups in the provision of legal

26. See Wiehoben, *Practice of Law by Motor Clubs—Useful But Forbidden*, 3 U. CHI. L. REV. 296 (1936).

27. *In re Maclub of America, Inc.*, 295 Mass. 45, 49, 3 N.E.2d 272, 274 (1936).

28. *Automobile Club v. Hoffmeister*, 338 S.W.2d 348 (Mo. Ct. App. 1960).

29. *United Transp. Union v. State Bar*, 401 U.S. 576 (1971); *UMW v. Illinois State Bar Ass'n*, 389 U.S. 217 (1967); *Brotherhood of R.R. Trainmen v. Virginia State Bar*, 377 U.S. 1 (1964); *NAACP v. Button*, 371 U.S. 415 (1963).

30. See *United Transp. Union v. State Bar*, 401 U.S. 576 (1971); *UMW v. Illinois State Bar Ass'n*, 389 U.S. 217 (1967); *Brotherhood of R.R. Trainmen v. Virginia State Bar*, 377 U.S. 1 (1964).

31. See *NAACP v. Button*, 371 U.S. 415 (1963).

32. See generally B. CURRAN, *THE LEGAL NEEDS OF THE PUBLIC* (1977); B. CURRAN & F. SPAULDING, *THE LEGAL NEEDS OF THE PUBLIC: A PRELIMINARY REPORT OF A NATIONAL SURVEY* (1974).

services began as an accidental by-product of the civil rights movement. *NAACP v. Button*³³ involved an attempt by the State of Virginia to enjoin the NAACP from compensating lawyers who represented impecunious litigants in school discrimination cases. The Virginia barratry statute, which the NAACP's activities contravened, had recently been expanded as part of a "general plan of massive resistance to the integration of schools of the state under the Supreme Court's decrees."³⁴ The Supreme Court observed that the NAACP was seeking to vindicate constitutional rights, and concluded that the activities of its legal staff were modes of expression protected by the first and fourteenth amendments, which a state could not prohibit under its power to regulate the legal profession.³⁵

In *Brotherhood of Railroad Trainmen v. Virginia State Bar (Trainmen I)*,³⁶ a scheme that involved recommendations of lawyers by a union to injured members also was held to involve freedom of speech and association. The union was concerned about the cost and quality of legal assistance received by its members, as well as inadequate compensation for on-the-job injuries. It identified lawyers who were experienced in employee injury work and willing to limit their fees, and then recommended use of these attorneys to union members. The Supreme Court saw no threat to legal ethics in this activity: "The railroad workers, by recommending competent lawyers to each other, obviously are not themselves engaged in the practice of law, nor are they or the lawyers whom they select parties to any soliciting of business."³⁷ Nothing more than speech and association was involved, and the first amendment could not be abrogated under the guise of regulating the ethics of the legal profession.

The *UMW v. Illinois State Bar Association*³⁸ case presented a more difficult issue. The union employed a lawyer to represent its members without charge in workmen's compensation cases, rather than merely

33. 371 U.S. 415 (1963).

34. *NAACP v. Patty*, 159 F. Supp. 503, 515 (E.D. Va.), *rev'd sub nom. Harrison v. NAACP*, 360 U.S. 167 (1958). *Patty* was the *Button* case at the district court level; the Supreme Court reversed and remanded with instructions that plaintiffs be allowed to seek an authoritative interpretation by the Virginia courts of the statute in question. The Virginia Supreme Court upheld the constitutionality of the statute. *NAACP v. Harrison*, 202 Va. 142, 116 S.E.2d 55 (1960), *rev'd sub nom. NAACP v. Button*, 371 U.S. 415 (1963). The organized bar unfortunately was a willing accomplice in the state scheme.

35. 371 U.S. at 428-29.

36. 377 U.S. 1 (1964).

37. *Id.* at 6-7.

38. 389 U.S. 217 (1967).

recommending lawyers as in *Trainmen I*. Members were free to refuse representation by the union lawyer and to retain another one, but at their own expense. The Court attached little significance to this difference:

Here, to be sure, the attorney is actually paid by the Union, not merely the beneficiary of its recommendations. But in both situations the attorney's economic welfare is dependent to a considerable extent on the good will of the union, and if the temptation to sacrifice the client's best interests is stronger in the present situation, it is stronger to a virtually imperceptible degree.³⁹

The attempt to prohibit this plan was held unconstitutional because it would impair the associational rights of the union members and was not needed to protect the state's interest in high standards of legal ethics.⁴⁰

These three cases, taken together, represented a frontal assault on the bar's control over initiation of client contacts and payment for the services of lawyers. The response of the organized bar, unveiled in its new Code of Professional Responsibility, was recalcitrant and myopic. Cooperation with organizations furnishing legal services was authorized "only in those instances and to the extent that controlling constitutional interpretation at the time of the rendition of the service *requires* the allowance of such legal service."⁴¹ Any cooperation with a group legal services plan beyond what was constitutionally mandated was declared to constitute unethical behavior, and subjected the participating lawyer to disciplinary sanctions.

After adoption of the Code, one further attempt at restricting collective action to obtain meaningful access to the courts was made by a state bar, but this effort was firmly rebuffed by the Supreme Court in *United Transport Union v. State Bar (Trainmen II)*.⁴² This decision adds little to the legal principles adopted in the three earlier cases. Its outcome was sufficiently predictable that a member of the ABA Committee on the Unauthorized Practice of Law was moved to observe:

For the fourth time in eight years the Supreme Court had to explain to lawyers that the bar's powers of discipline could not be used to

39. *Id.* at 224. Justice Harlan, in dissent, questioned the factual validity of this conclusion. *Id.* at 230-33 (dissenting opinion).

40. *Id.* at 225.

41. ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 2-103(D)(5) (1971) (amended 1974) (emphasis added). Legal aid and defender plans, military legal assistance offices and approved lawyer referral schemes were excepted. *Id.*

42. 401 U.S. 576 (1971). *United Transport Union and Brotherhood of Railroad Trainmen* are different names for the same union. *Id.* at 577 n.1.

restrict access to the courts. You should note the rather impatient tone of the majority opinion of Mr. Justice Black, shared also by the concurring opinion of Mr. Justice Harlan. Evidently the Court is getting weary of telling the bar something it should have understood long ago.⁴³

The Code's group legal services provisions have been amended twice since the *Trainmen II* decision was handed down.⁴⁴ Lawyers are now permitted to cooperate with group plans if there is no interference by the group in the attorney-client relationship.

C. The Expansion of Legal Aid

The creation of a substantial federally funded legal services program in the mid-1960's as part of the war on poverty was an important precursor of the revolution in the delivery of legal services described in this article.⁴⁵ The organized bar, particularly the ABA, supported this effort, though there was isolated opposition at the local and state level.⁴⁶ The legal services program provided access to the legal system for people who could not otherwise afford it, and thereby increased utilization of lawyers without a loss of work for private practitioners. The assurance that potential paying clients would not be served by the new legal services projects was a condition of ABA support.⁴⁷ A few marginal lawyers lost some legal business, but on balance the private bar gained both clients and income because the legal services program had an enormous educational effect.⁴⁸ These projects also functioned as a lawyer referral service; applicants who exceeded program income guidelines were directed to private practitioners.

The legal aid experience demonstrated what was previously only a

43. Stolz, *Sesame Street for Lawyers: A Dramatic Rendition of United Transport Union v. The State Bar of Michigan*, UNAUTH. PRAC. NEWS, Nov. 1971, at 14, 15.

44. Armstrong, *supra* note 1, at 1070, details the changes.

45. See E. JOHNSON, JUSTICE AND REFORM: THE FORMATIVE YEARS OF THE OEO LEGAL SERVICES PROGRAM (1974); Huber, *Thou Shalt Not Ration Justice: A History and Bibliography of Legal Aid in America*, 44 GEO. WASH. L. REV. 754 (1976).

46. Bethel & Walker, *Et Tu Brute*, TENN. B.J., Aug. 1965, at 11. Some of the concern stemmed from philosophical objections to government funding. Only a few years before the OEO Legal Services Program was created, a former ABA president observed: "What are the trends toward regimentation of our profession? To me, the greatest threat, aside from the undermining influences of Communist infiltration, is the propaganda and campaign for a federal subsidy to finance a nationwide plan for legal aid and low-cost legal service." Storey, *The Legal Profession Versus Regimentation: A Program to Counter Socialization*, 37 A.B.A.J. 100, 101 (1951).

47. Program guidelines provided that "fee generating cases," of which tort claims are the most obvious example, were to be referred to private lawyers.

48. The same phenomenon has been observed in England. "Far from drawing work away from private practitioners, law centers actually generated new clients for them." Zander, *Judicare or Staff? A British View*, 64 A.B.A.J. 1436, 1437 (1978).

matter of speculation: the majority of Americans, who rarely if ever use lawyers, do have problems that are amenable to legal solutions, but they are deterred from seeing a lawyer by concerns about cost. Within five years attorneys in federally funded legal services projects were handling more than one *million* cases per year, and most programs were turning away large numbers of potential clients. No one had imagined that such an enormous untapped desire for legal assistance existed. That the services were free certainly affected the number of people who came to legal services offices, but still the magnitude of client response was unexpected. Faced with this deluge of clients, legal services offices sought to expedite the handling of certain legal problems that recurred frequently, notably divorces, landlord-tenant disputes, and welfare matters. The use of lay advocates, paralegals, word processing equipment, and form pleadings proved that repetitive client matters could be processed rapidly, competently, and inexpensively.⁴⁹

Attorney independence was a major concern of the bar, and it was met by carefully drawn program guidelines designed to ensure that no interference with the attorney-client relationship would take place. Over two thousand legal aid lawyers ethically serving clients with the blessing of the bar gave lie to arguments that restrictions on group legal services were necessary to protect the public. Apart from the source of funding, legal services programs constitute closed panel group legal services programs, with the program's attorneys constituting the panel and those who meet poverty guidelines constituting the client group. The only real difference between legal aid programs, which the bar supported, and group plans, which the bar opposed, is that the group plans threaten to deprive some lawyers of paying business. Both forms of delivering legal services benefit the public and increase access to lawyers.

D. Restraints on Competition Among Lawyers

The group legal services cases involved efforts by users of legal services to increase their market power and to obtain better or cheaper legal assistance. The discussion now will shift to a series of Supreme

49. The one area in which legal aid lawyers were not ahead of the private bar in the rapid production of legal work was in the use of word processing equipment. Years of bare bones budgets for legal aid resulted in a fortress mentality. The investment of substantial funds in capital equipment, whether for purchase or lease, was regarded as either a luxury or a waste of money. Low secretarial salaries have for years resulted in high turnover and a staff that sometimes does not possess the skills to operate and maintain sophisticated word processing machines.

Court decisions between 1975 and 1978 involving restrictions on competition among members of professional groups. Until these cases, professionals prided themselves on their decision not to compete actively with one another. Indeed, the absence of rivalry among members was sometimes said to be one of the defining characteristics of a profession. Roscoe Pound stated the matter clearly:

There is no such thing as competition for clientage in a profession. Every lawyer should exert himself fully to do his tasks of advice, representation, and advocacy to the best of his ability. But competition with fellow members of the profession in any other way is forbidden. Competition belongs to activities which are primarily acquisitive. It is not allowable in those primarily for public service.⁵⁰

The Supreme Court has now decided that under the guise of rules of ethics professional groups, particularly lawyers, impose entirely too many restraints on economic activity of their members. In the process the Court abolished the doctrine that commercial advertising was "second class" speech and therefore entitled to only limited protection under the first amendment.⁵¹

1. Competitive Pricing

Two decisions invalidated provisions in the codes of ethics of professional groups that prohibited certain price competition between group members. In *Goldfarb v. Virginia State Bar*,⁵² plaintiff successfully attacked bar association minimum fee schedules, which were widely used by lawyers throughout the country. The Virginia fee schedule was unusual only in that it was mandatory. Generally, bar associations have been clever enough to state that fee schedules are merely advisory.⁵³ ABA ethics opinions have consistently taken the position that fee schedules "can only be suggested or recommended and cannot be made obligatory."⁵⁴

For years the bar decreed that price fixing through minimum fee schedules was in the public interest. The Supreme Court, however,

50. R. POUND, JURISPRUDENCE 677-78 (1959).

51. *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748 (1976), together with *Bigelow v. Virginia*, 421 U.S. 809 (1975), ended the commercial speech exception to the first amendment. The leading cases presenting the former rule are *Valentine v. Chrestensen*, 316 U.S. 52 (1936), and *Breard v. Alexandria*, 341 U.S. 622 (1951).

52. 421 U.S. 773 (1975).

53. DR 2-106(B) lists eight factors to be considered in determining a fee, one of which is the "fee customarily charged in the locality for similar legal services."

54. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 302 (1961).

viewed mandatory minimum fee schedules, which permit price competition only above specified dollar prices, as simple price fixing on behalf of bar members and a per se violation of the Sherman Act,⁵⁵ rather than as an acceptable form of professional regulation. The Court conceded that the Constitution did not mandate adherence to the ideas of Adam Smith, but it concluded that Congress had adopted competition as part of our national policy by enacting the antitrust laws, and that "anticompetitive conduct by lawyers is within the reach of the Sherman Act."⁵⁶ Once this conclusion was reached, bar association price fixing was easily condemned. The public interest is in lower prices not higher ones, and the bar was using professional regulation to increase profits for its members rather than to benefit the public.

Another price competition case, *National Society of Professional Engineers v. United States*,⁵⁷ challenged the validity of a provision in the code of ethics of the National Society of Professional Engineers that prohibited competitive bidding between engineers for contracts. The district court, court of appeals, and a unanimous Supreme Court all held that this practice constituted a violation of the Sherman Act.⁵⁸ The engineer's rule was condemned because it

[p]revents all customers from making price comparisons in the initial selection of an engineer, and imposes the Society's views of the costs and benefits of competition on the entire marketplace. It is this restraint which must be justified under the Rule of Reason, and petitioner's attempt to do so on the basis of the potential threat that competition poses to the public safety and the ethics of its profession is nothing less than a frontal assault on the basic policy of the Sherman Act.⁵⁹

The assertion by the engineering profession that "undue" weight would be given to price considerations was properly rejected. The society's code establishes qualitative standards for engineers that do not vary with the price paid by purchasers of their services. To the extent that shoddy work by engineers is a problem, the profession has a legitimate reason for concern, but the hiding of price information is not an effective response. It is normal in selecting among competing bidders to take into account proposal quality, a bidder's experience, interviews

55. 421 U.S. at 782-83; see 15 U.S.C. § 1 (1976).

56. 421 U.S. at 793.

57. 435 U.S. 679 (1978).

58. See 389 F. Supp. 1193 (D.D.C. 1974), *aff'd*, 555 F.2d 978 (D.C. Cir. 1977), *aff'd*, 435 U.S. 679 (1978).

59. 435 U.S. at 695.

with project managers, and a variety of other factors. The weight accorded to price in this equation is best decided by the purchasers of engineering services.

The services of attorneys are not ordinarily purchased by competitive bidding, but some major users of legal services might desire to obtain them in this manner. Early attempts to do precisely this were quickly rebuffed by the bar.⁶⁰ When a school board solicited bids for the performance of specified legal work, the ABA Committee on Professional Ethics ruled that submission of a bid to the school board would be unethical. That competition among lawyers would result was among the reasons for this conclusion.⁶¹ *National Society of Professional Engineers* would dictate an opposite result if a potential client were to seek such bids today.

Read together, *Goldfarb* and *National Society of Professional Engineers* suggest that provisions in professional codes that restrict price competition are unlikely to survive judicial scrutiny. At a minimum, it will be necessary to provide concrete evidence that the challenged practice serves the public interest.

2. Advertisements by Professionals

Consumers need information about available market alternatives if they are to make sound decisions. Rules of professional conduct have severely limited the information that may be disseminated to the public. In 1976, however, a state statute that prohibited pharmacists from advertising the price of prescription drugs was found to be inconsistent with first amendment rights when challenged by a consumer group. In *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*,⁶² the Supreme Court characterized the prohibition on price advertising as "highly paternalistic" and stated that its only effect on a pharmacist was to "open the way for him to make a substantial, and perhaps even excessive, profit."⁶³ The Court chose to assume that

60. ABA COMM. ON PROFESSIONAL ETHICS, INFORMAL OPINIONS, No. 83 (1953); MICHIGAN ETHICS OPINIONS, No. 133 (1950). See also H. DRINKER, LEGAL ETHICS 249-50 (1953).

61. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 292 (1957). The other reasons given were that the dignity of the profession would be lowered and that bidding would be injurious to the administration of justice.

62. 425 U.S. 748 (1976). The reasons why so much landmark litigation has involved Virginia law are considered in Falk, *Virginia Becomes a Handy Target for Lawyers Seeking Landmark Victories Before High Court*, Wall St. J., Sept. 8, 1978, at 40, col. 1.

63. 425 U.S. at 769. The Court recognized that advertising constitutes

[d]issemination of information as to who is producing and selling what product . . . and at what price. So long as we preserve a predominantly free enterprise economy, the

"people will perceive their own best interests if only they are well enough informed, and that the best means to that end is to open the channels of communication rather than to close them."⁶⁴

Chief Justice Burger, in a concurring opinion, agreed with this result because the services involved were routine. Today the pharmacist sells primarily prepackaged products rather than producing drugs from a supply of raw materials. Most pills and liquids are purchased in bulk by the pharmacist and sold either as is or after repackaging into smaller containers.⁶⁵

Virginia State Board of Pharmacy explicitly left open the question whether advertising by lawyers could be banned.⁶⁶ The subsequent case of *Bates v. State Bar*,⁶⁷ however, held that truthful advertisements about the availability and terms of sale for routine legal services could not be entirely prohibited, although such advertising could be regulated in a variety of ways.

In assessing the impact of the *Bates* case, it is important to recognize that the Code, and to a lesser extent the Canons, already permitted a wide variety of advertising by lawyers.⁶⁸ Patent, trademark and admiralty lawyers,⁶⁹ as well as state certified specialists,⁷⁰ were already allowed to advertise. Advertisements addressed to attorneys rather than the general public were permitted if they appeared in professional announcements or "reputable" law lists.⁷¹ Legal aid programs and lawyer referral services have long been allowed to publicize their availability because no competition among lawyers is involved.⁷² And attorneys have always been permitted to communicate with existing clients for the purpose of obtaining further business.⁷³

allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that those decisions . . . be intelligent and well informed. To this end, the free flow of commercial information is indispensable.

Id. at 765.

64. *Id.* at 770.

65. *Id.* at 773-74 (concurring opinion).

66. *Id.* at 773 n.25.

67. 433 U.S. 350 (1977).

68. The Code condones publicity that arises incidentally from the use of office signs, business cards, announcements of change in address or firm membership, running for elected office, professional publications and other sanctioned ways of having one's name and profession become known. See DR 2-101(B).

69. DR 2-105(A)(1). These specialties were exempted for historical reasons. EC 2-14.

70. DR 2-102(A)(4).

71. DR 2-102(A)(6).

72. DR 2-101(B)(6).

73. New legal rulings may be brought to the attention of existing clients but not to others, for

Within a year after the *Goldfarb* decision, the ABA had amended the Code to permit specified lawyer advertising directed to the general public.⁷⁴ Among the information that an attorney could convey was office location, current clients (with their consent), limitation of practice, schools attended, languages spoken, fee for initial consultation, and availability of credit arrangements. It is thus clear that the bar had largely abandoned attempts to prohibit advertising before the *Bates* decision. The present rule is that lawyer advertising is permitted,⁷⁵ with a few exceptions,⁷⁶ even though the Code does not say so explicitly.

3. Solicitation of Clients

The difference between advertising and solicitation is one of degree. The former involves dissemination of information to a large group of potential clients and the latter involves a message addressed to one person, or occasionally a small group.⁷⁷ The disdain solicitation evokes is based primarily on concern about a single situation: the obtaining of legal business from recently injured persons, most often as the result of an automobile or job-related accident. This "ambulance chasing" involves a number of unsavory practices. Some lawyers employ "runners" or "investigators" to obtain the clients, in violation of the Code. Payment is made to ambulance drivers, wreckers, hospital personnel, and others who steer business to a lawyer, even though these payments are prohibited by the Code.⁷⁸ Payments to public officials, notably police officers, and other violations of the criminal law are a frequent concomitant of ambulance chasing.⁷⁹ Potential clients are

that would amount to thinly disguised advertising. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 213 (1941); ABA COMM. ON PROFESSIONAL ETHICS, RECENT ETHICS OPINIONS, Informal Opinion No. 1356 (Nov. 25, 1975). "Periodic notices might be sent to the client for whom a lawyer has drawn a will, suggesting that it might be wise for the client to reexamine his will to determine whether or not there has been any change in his situation requiring a modification of the will." ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 210 (1941).

74. DR 2-102(A)(5). Smith, *Making the Availability of Legal Services Better Known*, 62 A.B.A.J. 855 (1976), traces the developments leading to this change.

75. See EC 2-9, -10; DR 2-101 to -105.

76. DR 2-101 to -103, -105.

77. Solicitation of clients is not limited to our legal system. Mahatma Gandhi discovered analogous practices when he began to practice law in Bombay.

He was shocked to discover that not only the most humble vakils but also the most exalted barristers all obtained cases by paying touts, who hung about the court. Gandhi felt that the touts were a disgrace to the profession, and refused to have anything to do with them, so for several months he did not get a single case.

Mehta, *Mahatma Gandhi and His Apostles*, NEW YORKER, May 17, 1976, at 38, 52.

78. DR 2-103(B).

79. These and other horrors associated with ambulance chasing are considered in Huber, *Ambulance Chasing*, Hous. Law., Sept. 1976, at 10; Saden, *Inquiry Into Ambulance Chasing*, 34

pressured into retaining a lawyer they do not know and may not want or need. Frequently, the potential client is unable to make a sound decision because of the effects of the accident or of drugs being used in treatment.⁸⁰

In two companion cases involving the alleged solicitation of clients, the Supreme Court stated again that competition among professionals was required only when it serves the public interest. In *In re Primus*,⁸¹ a state bar attempted to discipline a lawyer who, working in cooperation with the American Civil Liberties Union, sought to sue the Medicaid program in connection with the sterilization of certain women. These facts are similar to those in *NAACP v. Button* in that an attorney was raising constitutional issues; the Supreme Court had no difficulty in holding that the lawyer could not be punished for her activities.

*Ohralik v. Ohio State Bar Association*⁸² involved a classic instance of ambulance chasing. The business of the driver of a car and her passenger was vigorously sought, both at a hospital and at their homes. Pressure was put on both of the injured parties and their parents. The driver verbally retained Ohralik, who used a hidden tape recorder to memorialize her consent, but she dismissed him a short time later. The client eventually paid legal fees to both Ohralik and the lawyer she subsequently retained. Ohralik argued that he had engaged in constitutionally protected advertising.⁸³ This claim is not implausible, for one can view solicitation as advertising focused on a very small audience instead of directed at the general public. It differs from conventional advertising, however, in that the message is delivered personally, and involves pressure on the individual being solicited, who is often particularly vulnerable to persuasion because of the recent accident. The Supreme Court emphasized that it was dealing with "in-person" solicitation. This involves a disservice to both individual and societal

CONN. B.J. 117 (1960); Schizer, *The Brooklyn Judicial Inquiry: A Record of Accomplishment*, 29 BROOKLYN L. REV. 27 (1962); Comment, *Settlement of Personal Injury Cases in the Chicago Area*, 47 NW. L. REV. 895 (1953). See also *In re Mitgang*, 385 Ill. 311, 52 N.E.2d 807 (1944); *In re Perrello*, 260 Ind. 254, 295 N.E.2d 357, cert. denied, 414 U.S. 878 (1973); *Kentucky State Bar Ass'n v. Donoghoe*, 486 S.W.2d 703 (Ky. 1972); *In re Greathouse*, 189 Minn. 51, 248 N.W. 735 (1933); Annot., 67 A.L.R.2d 859 (1959).

80. Employers and insurance adjusters also use pressure tactics. Ambulance chasing is sometimes justified as a way to protect people from waiving important rights. See M. FREEDMAN, *LAWYERS' ETHICS IN AN ADVERSARY SYSTEM* 113-25 (1975); Note, *Legal Ethics—Ambulance Chasing*, 30 N.Y.U.L. REV. 182 (1955).

81. 436 U.S. 412 (1978). Only Justice Rehnquist dissented.

82. 436 U.S. 447 (1978).

83. *Id.* at 455.

interests because it hinders rather than facilitates "informed and reliable decision-making," and is therefore a proper subject for state regulation.⁸⁴

E. Competition and Professional Services Today

This completes the review of recent decisions dealing with competition in the market for professional services. The Supreme Court has recognized the anticompetitive effect of a number of prohibitions contained in the ethical codes of lawyers and other professionals and has declared them to be unconstitutional or in violation of the antitrust laws. The Court has concluded that the public interest is best served by vigorous competition rather than by severe economic restrictions, even if those restrictions are legislatively sanctioned.

Justices Blackmun and Rehnquist, concurring in *National Society of Professional Engineers*, disagreed with the majority's intimation that "any ethical rule with an overall anticompetitive effect promulgated by a professional society is forbidden."⁸⁵ The majority opinion continued the Court's adherence to the view that a state may conclude that "forms of competition usual in the business world may be demoralizing to the ethical standards of a professional," and therefore a state may regulate or even ban some competitive activity.⁸⁶ The subsequent decision in *Ohralik* constitutes evidence that the Court is really willing to treat professionals differently from other businesses, at least in the context of in-person solicitation. A similar restriction outside the professional context would clearly violate the Sherman Act. But *Ohralik* also demonstrates that the Court will uphold a professional rule that limits competition only when the rule serves the public interest.⁸⁷

II. THE CODE OF PROFESSIONAL STANDARDS: RECOMMENDATIONS

The focus of attention will now shift from past challenges of ethical restrictions to an examination of restraints presently in the Code. The Code still contains numerous provisions that have no place in a body of rules on professional conduct because they have little or no

84. *Id.* at 457-58 (quoting *Bates v. State Bar*, 433 U.S. at 364).

85. 435 U.S. at 699 (concurring opinion).

86. *United States v. Oregon State Medical Soc'y*, 343 U.S. 326, 336 (1952), *quoted with approval in* *Goldfarb v. Virginia State Bar*, 421 U.S. at 792; *accord*, *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. at 696.

87. This principle would not preclude controls over a form of legal practice if in the public interest. For example, law firms are commonly permitted to incorporate, but they may not limit their liability to clients. DR 6-102.

justification except as restraints on economic activity. These will be considered under four headings: forms of practice; obtaining business; fee arrangements between attorneys and clients; and financial dealings between lawyers and nonclients. In each instance it will be argued that present restrictions should be eliminated unless they are demonstrably beneficial to the public.

The evaluative standard will be different from that used by the courts, which assesses existing professional norms according to whether they comport with statutory and constitutional requirements. The discussion here will focus on what ought to be the content of professional rules for lawyers.⁸⁸ Since it will be recommended that a number of restrictions contained in the Code be eliminated, the presentation below will be organized around an examination of the relevant Code provisions. A reconsideration of the special rules of behavior for lawyers presents a good opportunity for the profession to complete the job that the courts have begun.

A. Forms of Practice

The Code limits the manner in which legal assistance may be delivered. Despite the group legal services cases discussed earlier, some unwarranted restraints on group plans remain. Restrictions on ownership interests by nonlawyers in organizations that practice law and on the simultaneous practice of law and another profession should also be eliminated. Certain restrictions on business relations with clients are appropriate and should be retained.

1. Group Legal Services⁸⁹

Limitations on the existence and operation of group legal plans are

88. These recommendations are not necessarily mandated by the Sherman Act, the first amendment or other legal standards.

89. The development of group legal plans, many of which are financed through prepayments by group members, is dictated by rules having little to do with the practice of law. Whether the prepayment feature constitutes "insurance" is a question of more than academic interest because in some states it will determine whether plans are subject to state insurance regulations. *See, e.g., Feinstein v. Attorney Gen.*, 36 N.Y.2d 221, 326 N.E.2d 288, 366 N.Y.S.2d 613 (1975).

Groups have been and will continue to be developed in the employment context because of the favorable tax treatment given to employer contributions. Neither the money paid to a qualifying group legal services plan nor the value of legal assistance provided under such a plan constitutes income to the employee. I.R.C. § 120. Plans must qualify under I.R.C. § 501(c)(20). Labor unions have taken the lead in creating prepaid group legal plans because their members have typically been unable to afford private lawyers, but were too well off for legal aid. Collective bargaining about legal services as a fringe benefit is allowed by national labor legislation. Labor Management Relations Act § 302(c), 29 U.S.C. § 186(c)(8) (1976).

largely a matter of history. Two restrictions still remain that may be inconsistent with articulated Supreme Court standards and that should in any event be excluded from the Standards.

The Code appears to permit cooperation by lawyers with a plan that furnishes legal services to its members only if the plan includes an "opt-out" provision, which permits members to be reimbursed for retaining counsel outside the normal framework of the plan.⁹⁰ Since the plan that the Supreme Court approved in *UMW v. Illinois State Bar* provided free legal assistance from a single attorney employed by the union but did not include an opt-out provision, the limitation in the Code appears to be clearly unconstitutional. The requirement that an opt-out provision be included also endangers the economic basis of group plans because they depend on volume handling of the repetitive problems that frequently arise in representing a relatively homogeneous group, such as railway or mining employees. Ethical rules should not hinder the efficient handling of these repetitive legal matters.

The Code prohibits lawyers from creating groups for which they will then do legal work.⁹¹ The result is that existing groups can obtain inexpensive legal services for their members, while those people who are not organized into large groups, and who therefore may be most in need of assistance, are left out. By prohibiting lawyers from forming group legal plans, the Code excludes those who are most likely to have the knowledge and desire to create them. One hopes that lawyers can create group plans at least as well as others, and therefore permitting this activity would better serve the public interest than precluding it. Accordingly, the Standards should allow lawyers to participate in the formation of groups for which they will perform legal services, subject to the rules concerning solicitation.

2. Ownership of a Law Practice

The Code permits only attorneys to share in profits earned from the practice of law.⁹² The public interest surely does not require that lawyers be granted a monopoly over the profits of lawyering, and such a limitation should not appear in the Standards. If price is low and quality of service is high, clients will be happy whether the profit

90. DR 2-103(D)(4)(e).

91. DR 2-103(D)(4)(b).

92. DR 3-102, 5-107(C)(1). Employees of a lawyer or law firm, however, may be included in a retirement plan even though it is based on a profit-sharing arrangement. DR 3-102(3); ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 311 (1964).

earned goes to lawyers or others. There is no evidence that an ownership interest by nonlawyers in a law firm will lead to unethical practices. Attorneys are required to exercise independent judgment on behalf of clients, and complete fidelity is owed to the client irrespective of how or by whom the attorney is compensated.⁹³ There is no necessary relationship between attorney independence in serving clients and financial arrangements for the payment of services or the manner in which payments are subsequently divided. The pressure of large caseloads in legal aid societies and of "command influence" on military, government, and corporation lawyers are as strong as potential pressures from profit-oriented nonlawyer owners. The drive to make money is often strong in law firms, and promotion from associate to partner frequently depends on the amount of billings that an attorney generates.⁹⁴ The duty of fidelity to individual clients is a valid and important principle, but it can be retained without regard to who shares the profits generated by a law practice.

The rule against nonlawyer ownership precludes some possibly useful legal practice arrangements. Restricting the provision of legal services on a for-profit basis to entities owned entirely by lawyers precludes a major retailer such as Sears or H & R Block from hiring attorneys and attempting to make a profit through the sale of legal services, as Sears does with insurance and Block does with tax advice. A law school graduate seeking to obtain funds to start a practice is permitted to give the lender a debt but not an equity interest in the law practice. It cannot be seriously argued that this distinction is necessary to protect the public or to ensure ethical lawyering. The present rule may work to the detriment of new lawyers seeking to start their own practices, particularly when interest rates are high or loan capital is scarce.

Included among the Code provisions that direct lawyers to assist in the prevention of the unauthorized practice of law is a prohibition against dividing legal fees with a nonlawyer.⁹⁵ This ban is justified in the following manner: "Since a lawyer should not aid or encourage a layman to practice law, he should not . . . share fees with a layman."⁹⁶ The conclusion simply does not follow from the premise. Practicing

93. DR 5-107(B), (C)(3).

94. One major Houston law firm prints and distributes to its lawyers on a monthly basis the billings of every attorney in the firm.

95. *See* DR 3-102.

96. EC 3-8. ABA CANONS OF PROFESSIONAL ETHICS No. 34 embodied the same rule.

law is one thing; sharing in the proceeds from the practice is quite another. If evidence existed that the division of legal fees or profits from a law practice frequently led to unauthorized practice or to inferior client service, such restrictions might be justified.⁹⁷ Absent demonstrated harm, the prohibition should be eliminated.

3. Dual Practice

Two distinct but similar situations are considered here. One is the practice of law and another occupation in partnership by two separate individuals, and the other is the practice of law together with another occupation by one person.

Although it is sometimes useful for a lawyer to work jointly with other professionals, the Code provides that lawyers are prohibited from forming partnerships with nonlawyers if any of the partnership activities constitute the practice of law.⁹⁸ For example, lawyers may be part of business consulting teams, which provide users with an array of expertise. Such partnerships easily avoid the Code restriction by billing separately for "legal" work. The net result is no more than to complicate needlessly the bookkeeping involved in the provision of a useful service.

An important aspect of the rule against forming a partnership with a nonlawyer has been the concern that the nonlawyer practitioner, whose profession might not prohibit advertising, would channel legal business to the attorney, and thereby evade the rule against advertising. Since attorneys may now advertise for clients, this justification is no longer relevant, and the prohibition should be abolished. If the nonlawyer partner engages in conduct prohibited by the Standards, the attorney partner would be accountable in the same manner as he is presently responsible for the actions of his agents, employees, and partners.

The simultaneous practice of law and another business or profession is permitted by the Code, but only if the attorney carefully disguises his dual practice.⁹⁹ Again, the major concern has been

97. The prohibition on the division of fees with laymen is particularly suspect in a jurisdiction such as Texas, which permits fee splitting with other lawyers. *See* Texas Code of Professional Responsibility, DR 2-107, TEX. REV. CIV. STAT. ANN. art. 320a-1 app. (Vernon 1973).

98. DR 3-103; ABA CANONS OF PROFESSIONAL ETHICS No. 33. This rule is a specific application of the principle that legal fees may not be divided with a nonlawyer.

99. DR 2-102(E).

circumvention of advertising restrictions, and the use of the other occupation to "feed" the law practice. After the *Bates* case and the recent amendments to DR 2-101, which permit an attorney to state extensive information including technical and professional licenses, and memberships in scientific, technical and professional associations, this rule has been effectively repealed.¹⁰⁰ The Standards should do so explicitly.

4. Business Relations With Clients

The Code imposes special duties on lawyers who participate in business activities with their clients.¹⁰¹ When the interests of the lawyer and client differ, and the client expects the lawyer to exercise legal judgment on the client's behalf, then full disclosure to and consent by the client are required. This rule prevents conflicts of interest without unduly limiting the activities of lawyers, and should be retained in the Standards. Some law firms take the position that they will never assume the dual role of advisor to and coparticipant with a client in a business venture.

B. Obtaining Business

The Code and Canons both included rules about the manner in which lawyers could obtain business (advertising, solicitation) and also about work reserved exclusively for lawyers (unauthorized practice). These will be considered in turn.

1. Advertising

The *Bates* case, together with the amendments to the Code recently adopted by the ABA, have abolished many restrictions on lawyer advertising.¹⁰² The Code prohibits publicity by or on behalf of an attorney except as allowed by its provisions, although the exceptions have largely consumed the rule.¹⁰³ The Standards should adopt the opposite approach and permit advertising subject to enumerated limitations. All advertising that is not false, deceptive, or misleading should be allowed unless specific harm is demonstrated.

100. See DR 2-101(B)(12), (13) (adopted Aug. 1977, 63 A.B.A.J. 1234, 1235 (1977)).

101. DR 5-104(A).

102. Changes in this area have come so rapidly that the present rules about attorney advertising vary substantially between states. This is the only topic discussed in this article in which the position adopted by the Code is not accepted almost universally in American jurisdictions.

103. DR 2-101, reprinted in 63 A.B.A.J. 1234, 1235 (1977).

The current state of advertising rules can be conveniently considered through an examination of the information a lawyer may want to convey to the public. The most important message is that the lawyer exists and that he can be found at the given address.¹⁰⁴ In addition, potential clients will want to know the type of work a lawyer does, the amount charged, and that the lawyer provides quality services. Although *Bates* covered only price advertising of routine legal services in newspapers, the Standards should specifically permit all accurate price information. If an hourly fee is stated correctly (for example, "we charge \$50 per hour"), it should not matter whether the legal services involved are "routine." The same is true if a contingent fee is accurately advertised. Stating a flat rate for a particular service, such as preparing a will, is not misleading or unfair so long as the attorney performs the advertised service for the amount stated. Statement of a minimum price (\$150 and up) should also be allowed. If the public can be trusted to survive the blandishments of the automobile industry, it can also deal with truthful advertisements by lawyers.

Amendments to the Code adopted in 1977 permit an attorney to advertise that his practice is limited to certain areas of law.¹⁰⁵ States should adopt lists of identifying labels for types of legal work, the use of which would be mandatory for lawyers who want to state that they limit their practice. Such a truth-in-labeling rule is necessary for meaningful information to be conveyed to consumers.

The major remaining concern about lawyer advertising relates to statements about quality. This concern is unfounded. Professional licensure guarantees a basic level of competence; with that protection clients can make decisions about lawyers as capably as they decide about other major expenditures. If a lawyer chooses to promise more than "best efforts," a warranty will be created. If a lawyer guarantees a certain result, failure to achieve it will constitute a breach of contract.¹⁰⁶ Most quality claims, however, are likely to be mere puffs (for

104. The advertisement that probably brought the most business to a law firm said nothing specific about price or quality of services.

The Dan Walker Law Office has been established by former Governor Walker in eight cities in Illinois. The United States Supreme Court has decided that for the first time lawyers may advertise in newspapers, with certain limitations. The Supreme Court reasoned, and we agree, that legal services should be available to more people at a reasonable rate. We offer a broad range of legal services to people and businesses across the state. [Firm name, address and telephone numbers followed.]

Chicago Sun Times, July 3, 1977, at 5, col. 4.

105. DR 2-101(B)(2), -105(A)(2), *reprinted in* 63 A.B.A.J. 1234, 1235 (1977).

106. *Cf. Hawkins v. McGee*, 84 N.H. 114, 146 A. 641 (1929)(doctor-patient relationship). *See*

example, "we do a wonderful job" rather than actionable promises. At worst, this is unhelpful to the consumer. Unless one wants to argue that incomplete information is worse than none at all, however, restraints on advertising of price or quality of legal services are unjustifiable. As has already been demonstrated, the Supreme Court has become hostile to the argument that restricting market information benefits the public. At most, disclaimers should be required; these are probably unnecessary, but they represent a substantial improvement over a prohibition on information about quality.¹⁰⁷ Attorney advertising is subject to existing consumer protection and deceptive trade practice laws. The Standards might provide that the violation of such rules constitutes unprofessional conduct.

The opinion of the Court in *Bates* specifically set aside use of the broadcast media for lawyer advertising as potentially warranting special treatment.¹⁰⁸ The 1977 Code amendments authorized radio advertisements.¹⁰⁹ Several states also permitted television advertising¹¹⁰ without apparent ill effects, and in 1978 the ABA House of Delegates approved its use by a wide margin.¹¹¹ There has been little sustained use of television advertising,¹¹² largely because the purchase of television time is so expensive.¹¹³ Lawyers interested in television advertising are likely to make increasing use of UHF or cable channels, which reach a more localized audience and charge substantially less for their time than VHF stations.

The bar should gracefully retreat from the whole area of lawyer advertising, making provision in the Standards only for a prohibition of false, misleading, or deceptive advertisements. On balance, advertising is good for both the profession and the public.

also Steinberg & Rosen, *Lawyers' Advertising and Warranties: Caveat Advocatus*, 64 A.B.A.J. 867 (1978).

107. The experience with health warnings on cigarette advertisements leads one to be skeptical of whether disclaimers effectively communicate information.

108. 433 U.S. at 384.

109. DR 2-101(B), reprinted in 63 A.B.A.J. 1234, 1235 (1977).

110. 64 A.B.A.J. 1341 (1978).

111. *Id.*

112. Hochberger, *Lawyer Advertising—Update After One Year*, N.Y.L.J., June 26, 1978, at 1, col. 4. Hochberger concludes that the impact of *Bates* on a national basis has been minor. *Id.* at 2, col. 5.

113. Advertisements in the yellow pages of the telephone book and in newspapers of general circulation are also expensive. In large cities a local audience might be reached most effectively by advertisements in community papers. Lawyers who specialize in the legal problems of specific groups or industries might advertise in their trade publications. See *id.* at 1, col. 4.

2. Solicitation

An understanding of when and why solicitation occurs is a necessary predicate to determining what, if anything, should be done about it. Solicitation is expensive in most situations and would not occur even if permitted by the Code. Ambulance chasing is the classic, and most reprehensible, form of solicitation.¹¹⁴ It involves several features that make it attractive for business-seeking lawyers. The injured person is very likely to need a lawyer and to recognize this. The likelihood of that person being already represented by counsel is relatively low because the event causing the injury was unplanned. Conveniently, the injured potential clients are transported to centrally located hospitals. Most important, a lawyer need not be concerned about his injured client's financial status because the case, if brought to a successful conclusion, will produce a *res* out of which the attorney's fee can be paid. Widespread solicitation is unlikely to occur when this fortuitous combination of circumstances is absent.

Lawyers, like others who earn a living by selling something, long ago discovered that if they were gregarious and spent time with potential buyers the result might be to generate some business. If at a cocktail party a lawyer states his profession to a person who then mentions a problem whereupon the lawyer says he can help, has the advice of the lawyer been sought or is impermissible solicitation involved? The answer in practice is that such activity is acceptable, though it can be argued that the Code, which provides that for an attorney to recommend himself "to a non-lawyer who has not sought his advice regarding employment of a lawyer" constitutes prohibited solicitation,¹¹⁵ requires the opposite conclusion. While professionals who constantly talk about their work may be regarded as boorish, dull or even rude, they are not unethical. If overreaching is the concern or if the Code

114. Ambulance chasing has no real defenders apart perhaps from some lawyers who benefit from it. The closest thing to support is M. FREEDMAN, *supra* note 80 (chapter titled *Access to the Legal System: The Professional Responsibility to Chase Ambulances*). More recently Professor Freedman has recommended that the Code (1) eliminate restrictions on solicitation; (2) urge dignity in advertising; (3) prohibit communications with potential clients that violate valid laws or regulations, or would breach an obligation of a third person through whom he communicates (e.g., hospital employees, peace officers); and (4) forbid solicitation of those who prefer to be left alone. Freedman, *Advertising and Solicitation by Lawyers: A Proposed Redraft of Canon 2 of the Code of Professional Responsibility*, 4 HOFSTRA L. REV. 183, 198-203 (1976).

In the course of investigating ambulance chasing, the author spoke with several hospital administrators. Their chief concern about ambulance chasers was the problems they caused in operating the hospital, sometimes even endangering the lives of patients. See, Huber, *supra* note 79.

115. DR 2-103(A).

provision is designed to protect a potential client from making an unwise or hurried decision, a solution might be to require the contract of employment to be in writing or to provide a "cooling off" period as is done with sales in the home.

The prohibitions on seeking clients reflect a concern about the conflict of interest inherent in a lawyer suggesting the need for legal services and then performing the recommended work. The circumstances under which the client agrees to be represented by the lawyer are not a material consideration. In evaluating encounters between lawyers and potential clients, the Code makes no distinction between the person who is pressured into immediately becoming a client and the person who becomes a client by telephoning the attorney several days after their encounter. Only the former situation warrants regulation, because it involves in-person solicitation.

A final form of activity that arguably involves solicitation is direct mail. Letters containing the sender's message are mailed to the homes of selected individuals. For example, an attorney commencing practice in a town might desire to communicate his availability to the thousand richest people in the vicinity, on the theory that they are likely to be particularly desirable clients. A lawyer opening an office in a suburban area might want to notify nearby residents of this fact. In either instance assume the attorney writes a standardized letter containing information that would comply with the Code's advertising provisions if published in a newspaper advertisement. The letter is reproduced on a word processing unit so that each copy is individually typed, and each is signed by the attorney. Solicitation has two central aspects: a message directed to an individual and in-person delivery of that message. Only the latter aspect is objectionable, for it is personal contact that creates pressure. The Supreme Court in *Ohralik* emphasized that the evil involved with solicitation was the pressure inherent with in-person contacts. Personalized letters to potential clients should be permitted, though the Code now prohibits their use. Direct mail probably is constitutionally indistinguishable from the advertisement sanctioned in *Bates*.¹¹⁶

Solicitation is a greater problem in jurisdictions that allow full contract damages to an attorney who has been dismissed by a solicited

116. See *Kentucky Bar Ass'n v. Stuart*, 568 S.W.2d 933 (Ky. 1978).

client than in those jurisdictions that limit recovery to the value of services actually rendered. The law of contract, as well as ethical proscriptions in the Standards, should be used to curb in-person solicitation by attorneys and their agents. "Cooling off" legislation might be adopted, though the efficacy of such statutes is open to question. Permitting clients to void contracts with attorneys entered into within one week after an accident or while hospitalized would have a dramatic effect on existing practices. Oral contracts of employment might also be treated as voidable by clients.¹¹⁷

3. Unauthorized Practice of Law

Unauthorized practice committees were born in a time of economic hardship to ensure that the profession did not lose business.¹¹⁸ No more than sporadic concern about unauthorized practice was expressed prior to 1930 when the ABA created its Committee on Unauthorized Practice.¹¹⁹ The organized bar has been active ever since in preventing competition¹²⁰ from outside groups.¹²¹ Emphasis has been on precisely those areas of practice in which other groups can perform almost as well as lawyers, such as the sale of residential property by

117. Waivers, releases and settlements should be voidable for a similar period of time.

118. Symposium, *The "Unauthorized Practice of Law" Controversy*, 5 LAW & CONTEMP. PROB. 1, 2 (1934).

119. Bristol, *The Passing of the Legal Profession*, 22 YALE L.J. 590 (1913), is an exception. Bristol observed that much legal business was being lost to title insurance companies and the trust departments of banks. He decried the loss of this "lucrative" work to other institutions that would do the work less expensively. He ends beweechingly:

And, my good brothers in law, you who are still within the pale of the profession, unincorporated and free to think for yourselves, how do you like it? Shall we continue to practice law as a profession, honor its traditions, cherish and live up to its high ideals, and die poor, or shall we fall in line with our more progressive brothers, pass over into the business world incorporate—exploit the public—and live rich?

Id. at 613.

120. This point of view is, of course, disclaimed by the bar. A former president of the ABA has observed:

Our concern in this subject matter [unauthorized practice] is governed by broad considerations of social policy and the public interest. It must not be motivated by selfishness or by avicious materialism. The lawyer who thinks that unauthorized practice work is simply a means for increasing his own income has no place in the discussion.

We are here to protect the public from the hidden dangers of dealing with the unlicensed and unauthorized practitioner, not to protect the lawyer from competition.

Marden, *The American Bar and Unauthorized Practice*, UNAUTH. PRAC. NEWS, Spring 1967, at 1, 2.

121. Often cartel arrangements, known as the "conference system," were entered into with other professional groups. The conference system is described in Perry, *Report of the Standing Committee on Unauthorized Practice of Law*, UNAUTH. PRAC. NEWS, Spring 1963, at 1. Agreements with other professions appear in 7 MARTINDALE HUBBELL, LAW DIRECTORY 71m (1978).

real estate brokers¹²² or divorce services that sell forms and surreptitiously give "legal" advice to the purchasers.¹²³ For many routine legal tasks, performance of all the work by an individual lawyer is expensive and inefficient. To obtain these legal services at a lower cost, much of the work must be performed by nonlawyers. Paralegals are permitted to perform nearly all tasks related to serving a client except for court appearances, so long as they do it under the supervision and control of a lawyer.¹²⁴ A few law firms already employ several paralegals for every lawyer, in addition to other support staff. Some legal assistance can be provided quite inexpensively if a large volume of the same or similar work is involved. Largely because of the advent of group plans and lawyer advertising, this possibility is becoming a reality.¹²⁵

The definition of what constitutes unauthorized practice remains a matter of state law, however. The Code simply provides that a lawyer should not aid a nonlawyer in the unauthorized practice of law.¹²⁶ So long as a state determines that certain activity is impermissible, the Standards cannot institute less restrictive unauthorized practice rules. Only a change in state law can accomplish this objective.

C. *Financial Arrangements: Attorney and Client*

The Code contains several provisions that unnecessarily limit the range of permitted fee arrangements between attorney and client. The Code states that fees should not be excessive, and a lawyer can be sanctioned for charging a "clearly excessive" fee.¹²⁷ Apart from doubts about whether the modifier "clearly" is needed, the rule is unobjectionable, but it is also so general that it is unenforceable. In a reasonably competitive market for legal services, excessive fees will not be a problem except in isolated instances, and consumer protection laws should suffice to deal with these. To the extent that the objective is to protect unsophisticated consumers from being overcharged, rules of professional behavior that cover only the conduct of attorneys are not the best vehicle for achieving the desired result. Many of the prohibitions on

122. See, e.g., *Chicago Bar Ass'n v. Quinlan & Tyson*, 34 Ill. 2d 116, 214 N.E.2d 771 (1966).

123. See, e.g., *People v. Divorce Associated & Publishing, Ltd.*, 95 Misc. 2d 340, 407 N.Y.S.2d 142 (Sup. Ct. 1978). The Florida State Bar Association spent \$94,000 to employ an attorney and four investigators last year to ferret out the unauthorized practice of law. *Brill, Divorce, Florida Style*, *ESQUIRE*, July 4, 1978, at 14.

124. EC 3-6.

125. Falk, *Legal Upheaval: Lawyers Are Facing Surge in Competition as Courts Drop Curbs*, *Wall St. J.*, Oct. 18, 1978, at 1, col. 1.

126. DR 3-101(A).

127. DR 2-106.

financial arrangements between attorneys and others appear to exist primarily if not totally for the protection of the bar. The key question in evaluating prohibited financial arrangements is whether they involve an actual or potential conflict of interest among the parties thereto, and if so, whether the conflict is sufficiently serious to warrant regulation.¹²⁸ When no substantial conflict can be demonstrated, contractual agreements should be permitted, subject to generally applicable consumer protection laws.

1. Contingent Fees

The Code states the general principle that "[a] lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation he is conducting for a client."¹²⁹ The most important exception is that attorneys are permitted to enter into contingent fee agreements with clients, which provide for the attorney to receive a percentage of the client's recovery.¹³⁰ This permits worthy claimants to bring suit even though they otherwise could not afford to retain a lawyer. Unfortunately, some lawyers have charged exorbitant fees, upon occasion exceeding fifty percent. Courts can regulate contingent fee practices, including the imposition of maximum fees, and a few courts have done so.¹³¹ Lawyers should present solvent clients with the alternative of an hourly fee for service or a contingent fee arrangement. Contingent fee abuses, often associated with ambulance chasing, can and should be curbed, but the general use of contingent fees should be retained.

Contingent fees are prohibited in criminal cases.¹³² This provision is of little consequence because lawyers would not utilize such a fee arrangement even if permitted to do so. This rule is an example of "self-paternalism" by the bar to protect its members from their own lack of foresight. Many criminal defendants are poor and desperate, and some lawyers might, in a moment of weakness or generosity, enter

128. In one sense all fee arrangements between lawyer and client involve a conflict of interest because the more the lawyer receives the more the client must pay. Courts could set fees and publish fee schedules, as the English have done for centuries.

129. DR 5-103(A).

130. EC 2-20; DR 5-103(A)(2). Contingent fees are forbidden in England. The arguments for and against their use are presented in Youngwood, *The Contingent Fee—Reasonable Alternative?*, 28 MOD. L. REV. 330 (1965).

131. Maximum fee schedules were upheld in *American Trial Lawyers Ass'n v. New Jersey Supreme Court*, 66 N.J. 258, 330 A.2d 350 (1974), and *Gair v. Peck*, 6 N.Y.2d 97, 160 N.E.2d 43, 185 N.Y.S.2d 491 (1959), *appeal dismissed, cert. denied*, 361 U.S. 374 (1960).

132. DR 2-106(C).

into a contingent fee arrangement with a client. Unlike tort cases, wherein contingent fees are used most frequently, criminal cases do not produce a *res* from which the attorney can obtain a fee.¹³³ It has been suggested that the use of contingent fees in criminal cases presents a danger of corrupting justice,¹³⁴ but there is no concrete evidence to support this proposition. The prohibition against contingent fees in criminal cases should be omitted from the Standards. It may be foolish to accept criminal cases on a contingency basis, but doing so should not be treated as unethical.

The Code discourages, but does not prohibit, the use of contingent fees in domestic relations cases.¹³⁵ Nevertheless, such arrangements are frequently utilized. When divorce itself is the contingency, a lawyer is in the unfortunate position of having a large financial stake in the dissolution of the marriage. This situation is worth serious investigation to determine whether important societal values are threatened by the use of contingent fees in family law cases.¹³⁶

2. Royalties

An attorney may not receive as his fee an interest in a publication concerning the subject matter of his employment.¹³⁷ A detailed justification is provided for this rule:

If, in the course of his representation of a client, a lawyer is permitted to receive from his client a beneficial ownership in publication rights relating to the subject matter of the employment, he may be tempted to subordinate the interests of his client to his own anticipated pecuniary gain. For example, a lawyer in a criminal case who obtains from his client . . . publication rights with respect to the case may be influenced, consciously or unconsciously, to a course of conduct that will enhance the value of his publication rights to the prejudice of his client.¹³⁸

133. In rare cases a fund of money may become available after an acquittal. A beneficiary of an insurance policy who is accused of murdering the insured may be entitled to the proceeds of the policy only if he is not convicted. The proceeds of a trust might be payable only if the claimant has never been convicted of a felony.

134. *Peyton v. Margiotti*, 398 Pa. 86, 40, 156 A.2d 865, 867 (1959). Perhaps the fear is that the acquitted defendant will be forced to commit a crime to pay his attorney.

135. "Because of the human relationships involved and the unique character of the proceedings, contingent fee arrangements in domestic relation cases are rarely justified." EC 2-20.

136. The experience in Texas, which permits contingent fees in family cases, appears satisfactory, but the issue requires a judgment that is considerably more informed than that of the author. See Texas Code of Professional Responsibility, DR 2-106(c), 5-103(A)(2), TEX. REV. CIV. STAT. ANN. art. 320-1 app. (Vernon 1973); TEXAS BAR COMM. OPINIONS, No. 349 (1969).

137. DR 5-104(B).

138. EC 3-4.

In a legal system that commonly uses contingent fees, that regularly permits a lawyer to represent codefendants in criminal cases, and that sanctions the representation of insured persons by attorneys selected and paid for by insurers, it is surprising that the royalty situation should be singled out for special treatment. A royalty agreement is unlikely to create a conflict of interest between attorney and client, or to endanger the proper functioning of the justice system, though it may offend the dignity of the profession, especially if given prominent notice by the media. The Standards should not retain the prohibition against royalty agreements between attorney and client, although it does not follow that they are to be encouraged. Of course, if a lawyer does not pursue his client's best interests he will be subject to discipline under other provisions in the Standards, regardless of the fee arrangements involved.

3. Loans to Clients

Attorneys are permitted to pay costs related to litigation and trial preparation on behalf of their clients so long as the client bears ultimate responsibility for these expenses.¹³⁹ An attorney may not, however, advance funds to a client for other purposes, such as living expenses.¹⁴⁰ There is much to be said for this position as a sound way to run a law practice. The object of practicing law is to get paid by clients, not to pay them. Legal fees are difficult to collect in the best of circumstances, and the client who needs to borrow money is the very one who is least likely to pay an attorney. Expenditures of money in connection with a client's business are directed toward completion of the legal work that is the basis for earning a fee. Loans to clients for other purposes are far less likely to be beneficial to the lawyer. The rule against loans to clients is another example of self-paternalism in the Code. It serves as a crutch for soft-hearted lawyers, who can respond to imploring clients, "I would love to help you out, but rules of professional ethics prohibit me from doing so."

Although the rule against loans to clients is rarely enforced, it has upon occasion been used to discipline lawyers who advance money to indigent clients.¹⁴¹ In labeling as unethical a lawyer who acts as a good

139. DR 5-103(B).

140. DR 5-103(B); EC 5-7, -8. Some jurisdictions have not adopted the ABA position on advancing living expenses. *See* Texas Code of Professional Responsibility, TEX. REV. CIV. STAT. ANN. art. 320a-1 app. (Vernon 1973).

141. *Mahoning County Bar Ass'n v. Ruffalo*, 176 Ohio St. 263, 199 N.E.2d 396 (1964). The dissenting opinion noted the inequity of suspending Ruffalo from the practice of law.

Samaritan and punishing him for acts of generosity, the Code reaches a shocking result. Such a provision may enhance the income of attorneys, but it has no place in a body of rules for professional behavior. Since advancing litigation-related expenses, which may involve thousands of dollars for depositions and expert witnesses, is permitted, it is ludicrous to suggest that advances for living expenses will compromise attorney independence. The disparate effect of the present rule on impecunious clients is an additional reason for its abolition.

D. Financial Arrangements: Attorney and Nonclients

1. Fee Splitting Between Attorneys

When an attorney forwards a case to another lawyer he may be compensated only for work actually performed and for the responsibility undertaken.¹⁴² This rule should be abolished because it does no more than ban a market arrangement that, at least arguably, will serve client interests better than the existing rule. This conclusion is based largely on the experience in Texas, which appears to be the only state to explicitly permit forwarding fees between attorneys.¹⁴³

Forwarding fees are used most commonly in tort cases. These cases are almost invariably handled on a contingent fee basis, and the cost to the client is the same whether or not the case has been forwarded. The common perception that clients will pay more for two lawyers than for one is simply not true. Only relatively valuable cases can be forwarded. Where fee splitting is banned, these cases are not

The railroad offers a meager totally inadequate settlement—a small percentage of what a lawful judgment could reasonably be expected. In making this inadequate settlement offer, the claims department of the railroad advises that the railroad can delay final decision for years. In short, the powerful can close the doors of the courts to the weak by reason of the lack of finances of the claimant.

Under the pronouncement in the case at bar, lawyers in Ohio are not permitted to give or loan financial assistance to a client even though the injured employee or the dependents in case of death are in want and hungry.

Id. at 273, 199 N.E.2d at 403 (Herbert, J., dissenting).

142. DR 2-107, ABA CANONS OF PROFESSIONAL ETHICS No. 34. The attorney must, of course, obtain the consent of his client before forwarding a case. DR 2-107(1).

143. The relevant part of the Texas version of DR 2-107 reads:

(A) A lawyer shall not divide a fee for legal services with another lawyer who is not a partner in or associate of his law firm or law office, unless:

(2) The division is made in proportion to the services performed and responsibility assumed by each, *or is made with a forwarding lawyer.*

Texas Code of Professional Responsibility, DR 2-107, TEX. REV. CIV. STAT. ANN. art. 320a-1 app. (Vernon 1973) (emphasis added). The italicized language has been added in the Texas version of DR 2-107. Otherwise the two provisions are identical.

forwarded because few lawyers are so successful that they can afford to give away cases that are likely to produce a substantial fee. Most lawyers will not do so, no matter what is stated in the rules of professional conduct, with the result that for the same fee clients will receive worse rather than better lawyering.¹⁴⁴

The fear that cases will be forwarded to lawyers who pay well rather than to those who will best serve the client is unfounded. The amount paid to the forwarding lawyer depends on the result achieved, and therefore the best available receiving lawyer will be sought out. The power to forward a case to a more qualified attorney also increases the bargaining power of less qualified attorneys, and thus inexperienced lawyers are able to obtain better settlements for their clients by threatening to refer the case to a leading trial lawyer. When lawyers are permitted to forward cases, grievance committees are better able to sanction lawyers who do an inept job of handling complex cases. For these reasons the Standards should permit fee splitting between attorneys.¹⁴⁵

2. Payments to Nonlawyers

Payments to laymen for recommending a lawyer are prohibited by the Code.¹⁴⁶ It is said that the public is best served if the recommendation of a lawyer is a disinterested one.¹⁴⁷ This rule is widely ignored, and violators are rarely punished. Lawyers should be permitted to pay laymen for steering clients to them if full disclosure is made to the client, except when prohibited by law (for example, payments to law enforcement officials), by institutional rules (for example, payments to hospital staff), or when solicitation rules have been violated. The issue is whether such payments can be made the basis of disciplinary action against a lawyer, not whether they are to be encouraged.

3. Contingent Fee Payments to Witnesses

The Code provides that payments to witnesses may not be made

144. The rule against forwarding fees is violated frequently throughout America. See Stokey, *Let's Re-Examine Fee Splitting*, 61 A.B.A.J. 1253 (1975). The forwarding lawyer typically receives one-third of the total fee. Upon occasion "responsibility assumed" is interpreted loosely as a device to avoid the proscription on fee splitting between attorneys.

145. One commentator would require that the fee arrangement be in writing, signed by the client and both lawyers, and subject to judicial scrutiny. See *id.* at 1254. See also G. HAZARD, *ETHICS IN THE PRACTICE OF LAW* 98-99 (1978).

146. DR 2-103(B).

147. EC 2-8.

contingent on the content of the testimony or outcome of the case.¹⁴⁸ The justification for this rule is self-evident in view of the truth-seeking purpose of trials.¹⁴⁹ The constitutionality of this prohibition was recently challenged by the plaintiff in a large antitrust case who argued that he could not afford the expert testimony needed to properly prove his claim unless he could utilize a contingent fee arrangement.¹⁵⁰ The proscription on paying contingent fees to expert witnesses was held constitutional because it did not affect a fundamental right or create a suspect classification.¹⁵¹

The drafters of the Standards should consider permitting such payments. The testimony of an expert witness differs in a fundamental way from that of other witnesses. Ordinary witnesses have knowledge about actual events involved in a case. The expert witness normally does not testify about the disputed facts in a case, but he presents specialized knowledge that may be useful in deciding a case. The primary problem with expert witnesses is that they are paid for their testimony. It is well known that certain experts appear repeatedly on behalf of plaintiffs or defendants. The relevant question to ask is whether this existing problem is exacerbated when the expert's payment is contingent on the outcome of the case. The Code rule is grounded in the concern that when the payment for testimony is dependent on the result of a case, the witness has an incentive to be less than truthful because a conflict between self-interest and truthfulness is involved. The purchase of testimony involves the appearance of wrongdoing, as well as an opportunity for actual impropriety. Perhaps professional pride, disclosure of the fee, and concern about disclosure during cross-examination, will cause experts compensated on a contingent basis to be as truthful as those compensated in other ways.¹⁵²

The Code rule favors the wealthier party in complex cases and defendant insurance companies in tort litigation. It is not self-evident,

148. DR 7-109(C). Payment of a reasonable fee for the professional services of an expert witness is permitted.

149. The argument that contingent payments to expert witnesses should be allowed because they are permitted for lawyers is a flawed one. The role of a lawyer is to be a partisan advocate, but the role of a witness is to be a purveyor of truth. The conflict of interest is far more serious in the latter situation.

150. *Person v. Association of the Bar*, 554 F.2d 534 (2d Cir.), *cert. denied*, 434 U.S. 924 (1977).

151. *Id.* at 539.

152. It is standard practice to elicit from an expert witness on cross-examination that he is being paid for his testimony. If contingent fees were permitted, their use would certainly be brought to the attention of the trier of fact.

however, that contingent fee payments to expert witnesses are evil. Unless it can be demonstrated that real harm is likely to occur from eliminating the present Code rule, an intermediate approach should be adopted that would allow the payment of a fee fixed in amount (either a total or a fixed hourly rate) to be made contingent on the outcome of a case, without allowing the actual amount of the fee to be contingent. Thus, a fee of \$500, or of \$100 per hour, if plaintiff wins, would be permitted, but a fee of two percent of the amount recovered by plaintiff would not.

III. CONCLUSION

Law may be the last cottage industry. When the United States declared its independence from Great Britain, Adam Smith had already observed a pin factory in which the task of making a pin was divided into eighteen separate tasks, and ten people produced about forty-eight thousand pins a day.¹⁵³ Automobile assembly lines long ago demonstrated that complicated as well as simple tasks can be performed more efficiently without loss of quality through the division of labor. Some, perhaps many, legal tasks can be performed both well and inexpensively through the use of paralegals, word processing equipment, preprinted forms and similar techniques. Only in the last few years, however, has serious consideration been given to practicing law in an efficient manner; previously, the profession earned high profits but served primarily the wealthy. The rules of proper professional conduct by attorneys, as embodied in the Canons and Code, carefully guarded against competition among lawyers and, along with state enforcement of unauthorized practice rules, tried to prevent encroachment by nonlawyers. The posture of the Standards should be to avoid restrictions on competitive activity among lawyers and the efficient delivery of quality legal assistance to the entire society.

It is appropriate to close with a word of caution. Many people who have not done so previously are using the services of lawyers; these lawyers will often be provided relatively inexpensively. Mass-produced products are less expensive but quality control problems occasionally arise. Marginal producers of goods and services sometimes cut corners, and uneducated consumers often are unhappy with their

153. A. SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 3 (London 1776).

purchases. The response of the professional has to be better quality control, not a limitation on competition.

DISQUALIFICATION OF THE TESTIFYING ADVOCATE—A FIRM RULE?

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In 1978, the California Supreme Court in *Comden v. Superior Court*¹ disqualified Loeb & Loeb, a seventy-five member Los Angeles law firm, from representing plaintiff in a litigation matter because the trial court concluded it could not say with any security that Marvin Greene, a member of Loeb & Loeb, would not be called as a witness in the trial.² The supreme court decision was the high point of a legal battle that continued even after the disqualification of Loeb & Loeb. When the skirmish on legal ethics finally ended (if it has ended),³ the attorneys for both plaintiffs and defendants were disqualified on the same ground: that a member of their firm ought to be a witness in the trial of the matter.

The disqualification of counsel for both sides in *Comden* naturally raises, if not forces, the question of the utility and practicality of the rule of ethics that resulted in the disqualifications. Even without the disqualifications of counsel for both sides, the necessity of disqualifying an entire firm because one member of the firm, who will not be trial counsel, may be a witness is questionable. Indeed, it is instructive that

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We would also like to thank Mr. Ron Stovitz, one of the attorneys for the State Bar of California, who supplied us with the amicus curiae brief of the State Bar and advised us of the action taken by the State Bar Board of Governors to amend the California rule; and Mr. Paul Devin of Peabody & Arnold (Boston, Mass.), who compiled a list of advisory opinions of bar association committees on this subject.

1. 20 Cal. 3d 906, 576 P.2d 971, 145 Cal. Rptr. 9, cert. denied, 99 S. Ct. 568 (1978).

2. Other members of Loeb & Loeb were also potential witnesses, but the supreme court attached less significance to their roles as witnesses. *Id.* at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

3. Loeb & Loeb's petition for certiorari to the United States Supreme Court has been denied. 99 S. Ct. 568 (1978).

State Bar Associations of California.⁴ New York and Connecticut⁵ have submitted briefs against such disqualifications.

This article will examine the rule that underlies such disqualifications, as it is presently written and enforced, and will examine the potential impact of the rule within and without the litigation context.⁶ We are, at the least, skeptical whether the rule serves any legitimate purpose. More important, we are convinced that the rule purposelessly interferes with the lawyer-client relationship and inhibits legitimate action by counsel both in the planning and preventive stages when the transaction is taking place, and throughout the litigation process. The rule unnecessarily complicates counsel's decision in representing a client, since a thoughtful attorney now has to keep in mind that as a result of any action he⁷ might take he could become a permanent witness and thus disqualify his firm from further representing his client in litigation. In response, the lawyer may refrain from taking otherwise appropriate action in order to protect the lawyer-client relationship, or may jeopardize the relationship that both lawyer and client have nurtured, or both.

I. THE LAW

Although the court in *Condon* applied a statute unique to California,⁸ that statute is derived from and is almost identical to two disciplinary rules contained in the ABA Code of Professional Responsibility, which was promulgated in 1969⁹ and became effective in 1970. Since 1970, the ABA Code has been adopted in all states and has also been adopted as the local rules of court in several federal districts. Even where not adopted, the Code may serve as a guide to trial judges in controlling the conduct of attorneys in their courtrooms.¹⁰

4. State Bar of California Brief as Amicus Curiae, *Condon v. Superior Court*, 20 Cal. 3d 96, 578 P.2d 873, 543 Cal. Rptr. 3, cert. denied, 99 S. Ct. 282 (1979).

5. New York State Bar Association Brief as Amicus Curiae, *International Elec. Corp. v. Flanner*, 507 F.2d 1298 (2d Cir. 1975); Connecticut Bar Association Brief as Amicus Curiae, *id.*

6. We will not, however, examine the rule as it applied to the trial counsel-witness, i.e., the lawyer who will appear in one matter before judge or jury both as lawyer and witness.

7. For simplicity, we have chosen the masculine gender when referring to counsel and client.

8. Rules of Professional Conduct of the State Bar of California, rule 2-111(A)(4), Cal. Bar & Assoc. Code tit. 3 § 6078 (West Cum. Supp. 1979).

9. DR 5-101(B), -102; see *International Elec. Corp. v. Flanner*, 507 F.2d 1298 (2d Cir. 1975).

10. *Commonwealth-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1548, 123 (D. Conn. 1976); *Stanwood Corp. v. United States, Inc.*, 77-615 (U.S. Ct. Cl., filed July 14, 1979).

The disciplinary rules of the ABA Code define those circumstances in which a lawyer may accept employment or may continue employment when he learns that he or a member of his firm ought to be called as a witness on behalf of his client or other than on behalf of his client.

DR 5-101

. . . .

- (B) A lawyer shall not accept employment in contemplated or pending litigation if he knows or it is obvious that he or a lawyer in his firm ought to be called as a witness, except that he may undertake the employment and he or a lawyer in his firm may testify:
 - (1) If the testimony will relate solely to an uncontested matter.
 - (2) If the testimony will relate solely to a matter of formality and there is no reason to believe that substantial evidence will be offered in opposition to the testimony.
 - (3) If the testimony will relate solely to the nature and value of legal services rendered in the case by the lawyer or his firm to the client.
 - (4) As to any matter, if refusal would work a substantial hardship on the client because of the distinctive value of the lawyer or his firm as counsel in the particular case.¹¹

DR 5-102

. . . .

- (A) If, after undertaking employment in contemplated or pending litigation, a lawyer learns or it is obvious that he or a lawyer in his firm ought to be called as a witness on behalf of his client, he shall withdraw from the conduct of the trial and his firm, if any, shall not continue representation in the trial, except that he may continue the representation and he or a lawyer in his firm may testify in the circumstances enumerated in DR 5-101(B)(1) through (4).
- (B) If, after undertaking employment in contemplated or pending litigation, a lawyer learns or it is obvious that he or a lawyer in his firm may be called as a witness other than on behalf of his client, he may continue the representation until it is apparent that his testimony is or may be prejudicial to his client.¹²

11. DR 5-101(B).

12. DR 5-102.

The disciplinary rules are not the only section of the Code of Professional Responsibility, but they are the most influential because they "state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action."¹³ They have been drafted to be enacted as law in various states and to be enforced by enforcing agencies, although the Code gives no indication of the role such agencies should play.¹⁴

The Code also contains ethical considerations that are "aspirational in character and represent the objectives toward which every member of the profession should strive."¹⁵ The ethical considerations "constitute a body of principles upon which the lawyers [and courts] can rely for guidance in many specific situations."¹⁶ The ethical consideration concerning an attorney's accepting or continuing employment when a member of the attorney's firm is a potential witness provides, in part:

Problems incident to the lawyer-witness relationship arise at different stages; they relate either to whether a lawyer should accept employment or should withdraw from employment. Regardless of when the problem arises, his decision is to be governed by the same basic considerations. It is not objectionable for a lawyer who is a potential witness to be an advocate if it is unlikely that he will be called as a witness because his testimony would be merely cumulative or if his testimony will relate only to an uncontested issue. In the exceptional situation where it will be manifestly unfair to the client for the lawyer to refuse employment or to withdraw when he will likely be a witness on a contested issue, he may serve as advocate even though he may be a witness. In making such decision, he should determine the personal or financial sacrifice of the client that may result from his refusal of employment or withdrawal therefrom, the materiality of his testimony, and the effectiveness of his representation in view of his personal involvement. *In weighing these factors, it should be clear that refusal or withdrawal will impose an unreasonable hardship upon the client before the lawyer accepts or continues the employment. Where the question arises, doubts should be resolved in favor of the lawyer testifying and against his becoming or continuing as an advocate.*¹⁷

Thus the ethical considerations, like the disciplinary rules, take a

13. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preamble.

14. *Id.*

15. *Id.*

16. *Id.*; see *Connell v. Clairol, Inc.*, 440 F. Supp. 17 (N.D. Ga. 1977); *Miller Elec. Constr., Inc. v. Devine Lighting Co.*, 421 F. Supp. 1020, 1023 (W.D. Pa. 1976); *Comden v. Superior Court*, 20 Cal. 3d 906, 576 P.2d 971, 145 Cal. Rptr. 9, *cert. denied*, 99 S. Ct. 568 (1978).

17. EC 5-10 (footnotes omitted) (emphasis added).

hard line by favoring withdrawal unless the client suffers an *unreasonable* hardship thereby. At the same time, however, the ethical considerations speak of an attorney's weighing factors, including the materiality of testimony and the effectiveness of his representation, before making the determination to resign. The disciplinary rules do not afford the lawyer even the luxury of subjective considerations to cushion later arguments.¹⁸ Rather, the disciplinary rules appear to objectify the lawyer's dilemma, which makes it even easier for a court to order disqualification.

Although enforcement of disciplinary rules 5-101(B) and 5-102 has not been uniform from one jurisdiction to the next, the courts have predominantly taken a strict approach.¹⁹ No court has adopted the approach suggested by the dissent in *Comden* that the withdrawal rule should be enforced only in bar disciplinary hearings rather than in the context of ongoing litigation.²⁰ Nor has any court held that a client has

18. This is the reverse of what it should be. The disciplinary rules, since they state a minimum level of conduct, are intended to be easier to comply with than the ethical considerations, which are aspirational; but in this instance, a lawyer might meet the standards in the ethical considerations while failing to comply with the disciplinary rules.

19. See, e.g., *Connell v. Clairol, Inc.*, 440 F. Supp. 17 (N.D. Ga. 1977). The courts are noticeably more lenient in applying DR 5-102(B) than DR 5-101(B) or DR 5-102(A). Disciplinary rule 5-102(B) applies when a lawyer or firm member may be called as a witness *other* than on behalf of his client. In such circumstances, the firm need not resign "until it is apparent that his testimony is or may be prejudicial to his client." DR 5-102(B); see, e.g., *Kroungold v. Triester*, 521 F.2d 763 (3d Cir. 1975); *Freeman v. Kulicke & Soffa Indus., Inc.*, 449 F. Supp. 974 (E.D. Pa. 1978); *Ross v. Great Atl. & Pac. Tea Co.*, 447 F. Supp. 406 (S.D.N.Y. 1978). The genesis of this distinction is clear. Neither the current rule nor its predecessor, which applied only to the trial lawyer who is a witness, was intended to allow counsel to disqualify opposing counsel by calling him as a witness. See *Galarowicz v. Ward*, 119 Utah 611, 620, 230 P.2d 576, 580 (1951), cited in ABA CODE OF PROFESSIONAL RESPONSIBILITY, canon 5 n.31. But in spite of its surface appeal, the distinction makes little sense. If an attorney ought to testify, the rationale for disqualifying his firm is equally applicable whether the testimony is on behalf of or contrary to the interests of his client. The real question when trial counsel calls his opponent is whether calling opposing counsel is warranted or is a tactical maneuver aimed at disqualification. Although this must be kept in mind in interpreting the disciplinary rules and the judicial constructions thereof, it is largely peripheral to the interests of this article. From this point forward we will ignore this distinction and concentrate on those cases in which the more common question, whether the attorney ought to testify on behalf of his client, is raised. Unless otherwise distinguished, the withdrawal requirement in disciplinary rules 5-101(B) and 5-102 will hereinafter be referred to as the "withdrawal rule."

20. 20 Cal. 3d at 918, 576 P.2d at 977, 145 Cal. Rptr. at 15 (Manuel, J., dissenting). Ironically, at least one court has said that the enforcement of the withdrawal rule by the court is not for the purpose "of obtaining an adjudication as to what constitutes professional misconduct on the part of an attorney, nor . . . for the purpose of laying down guide rules for the future conduct of an attorney on the speculation of what may develop during the litigation." *Tru-Bite Labs, Inc. v. Ashina*, 54 App. Div. 2d 345, 388 N.Y.S.2d 279 (1976).

the right to waive the enforcement of the rule.²¹ Rather, while the client's opinion has been suggested as a factor to be considered,²² the prevalent position is that although these disciplinary rules are for the protection of clients, they are also for the protection of the bar and the integrity of the court, and therefore may not be waived by the client.²³

The crucial question in determining whether the withdrawal rule applies in any situation is, when "ought" a lawyer testify at trial²⁴ on behalf of his client? Until it is determined that a lawyer ought to testify, his firm need not be disqualified.²⁵ The question, then, is not whether the attorney *will* be called, but whether he *ought* to be called, either in the case in chief or in rebuttal.²⁶ This, strangely, implies that in some instances a firm would be disqualified when a member ought to testify, even if it were clear that the member would not testify, and conversely, that a firm would not be disqualified when a lawyer would in fact testify even though he ought not.²⁷ There is a reason behind this

21. In *Town of Mebane v. Iowa Mut. Ins. Co.*, 28 N.C. App. 27, 220 S.E.2d 623 (1975), however, the court applied DR 5-101(B) and DR 5-102 by refusing to allow the testimony of the attorney rather than requiring disqualification of the attorney. This is, in effect, a waiver with a hook—that the client loses testimony he ought to have. See also *Jones v. South Dakota Children's Home Soc'y*, __ S.D. __, 238 N.W.2d 677 (1976).

22. *J.P. Foley & Co. v. Vanderbilt*, 523 F.2d 1357, 1359 (2d Cir. 1975) (Gurfein, J., concurring); *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1354 (D. Colo. 1976). See also ILLINOIS STATE BAR ASS'N. PROFESSIONAL ETHICS OPINION NO. 389 (1972); ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 339 (1975).

23. *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1068 (N.D. Tex. 1977); OREGON STATE BAR ASS'N COMM. ON LEGAL ETHICS, OPINIONS, No. 386 (1975). For this reason, they can be raised by the court on its own motion. 441 F. Supp. at 1067, and cannot be waived by opposing counsel. COUNCIL OF THE NORTH CAROLINA STATE BAR, ETHICS OPINIONS, CPR 62 (1975).

24. No case has interpreted the meaning of trial, or what it means to testify at trial. It is unclear whether testimony at trial includes a hearing on a preliminary injunction, as in *Comden*, or other instances when written and oral testimony is taken. The closest any case has come is deciding that a pretrial hearing in a criminal case is not a trial for purposes of the withdrawal rule. *People v. Superior Court*, 84 Cal. App. 3d 491, 502, 148 Cal. Rptr. 704, 711 (1978). But see *United States v. Treadway*, 445 F. Supp. 959 (N.D. Tex. 1978) (grand jury constitutes "trial").

The Illinois State Bar Association has opined that an affidavit offered in lieu of testimony would be testimony under the withdrawal rule. ILLINOIS STATE BAR ASS'N. PROFESSIONAL ETHICS OPINION NO. 540 (1977).

25. The question under DR 5-102(B) is whether the lawyer "may be called as a witness" rather than whether he "ought to testify," but this is coupled with the question whether the lawyer's testimony will be prejudicial to his client.

26. See *J.P. Foley & Co. v. Vanderbilt*, 523 F.2d 1357, 1359 (2d Cir. 1975); *Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127 (S.D.N.Y. 1978).

27. See *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486 (S.D.N.Y. 1976). See also *Universal Athletic Sales Co. v. American Gym Recreational & Athletic Equip. Corp.*, 546 F.2d 530, 538 n.21 (3d Cir. 1976) (arguing, perhaps only for sake of argument, that DR 5-101 and DR 5-102 do not apply to expert witnesses, since they cannot be characterized as witnesses who ought to testify).

strange approach, for the court is in the unlikely position of determining, as a lawyer, when a particular person ought to be a witness. Leaving this question in the hands of the trial counsel, who would normally determine who ought to be a witness, would allow the client, or the lawyer, to avoid the ethical question entirely by not calling counsel's colleague.²⁸

Since the court is not always in a position to determine accurately who actually ought to be called as a witness, courts have applied different standards and approaches to the problem. One approach is to describe generally the factors involved in loose, but loaded, prose. For example, the court in *Comden* discussed the issue as follows:²⁹

We deem the rule to require that the court first consider whether the attorney's testimony will be necessary to protect his client's interest and, if it concluded such testimony will likely be necessary, that it order a timely withdrawal consistent with minimizing prejudices which may result from the substitution of counsel. Whether an attorney ought to testify ordinarily is a discretionary determination based on the court's considered evaluation of all pertinent factors including, inter alia, the significance of the matters to which he might testify, the weight his testimony might have in resolving such matters, and the availability of other witnesses or documentary evidence by which these matters may be independently established.³⁰

This passage slithers from the question whether the attorney's "testimony will be necessary" to whether the testimony "will likely be necessary" to whether the attorney "ought to testify" under the circumstances. The court views the last question in terms only of the import of the testimony on establishing a matter, and of the import of this to the client's position in the trial. Thus, the context of the trial court's determination is purely the matter before it—presumably, at least, it would be inappropriate for the trial court to determine that a lawyer ought not testify in the matter before it, although the lawyer's testimony might be helpful and relevant, because that testimony would be damaging to the client in other ways.

As the broad stroke of the prose foreshadows, the court in *Comden* left the path clear for a trial court to disqualify trial counsel's firm by

28. The lawyer would still have the obligation, of course, to act competently.

29. It first gave the dictionary definition of "ought" in a footnote, as "'used to express moral obligation, duty, or necessity . . . or what is correct, advisable, or expedient.'" 20 Cal. 3d at 913 n.2, 576 P.2d at 974 n.2, 145 Cal. Rptr. at 12 n.2 (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1599 (1961)). This lent no light to the question.

30. *Id.* at 913, 576 P.2d at 974, 145 Cal. Rptr. at 12.

vesting the trial court with "broad discretion to order withdrawal."³¹ More specifically, the court held that it would not grant petitioner's writ of mandamus unless the facts commanded that the trial court's discretion could be exercised in but one way.³²

The court did not discuss when the facts would require that a trial court's discretion be exercised only one way, but the weakness of the motion to disqualify that was upheld in *Comden* is instructive. All of the facts witnessed by attorney Marvin Greene of Loeb & Loeb were witnessed by others. The most important piece of evidence to which Greene could testify was the hearsay statement by Anthony Strammiello that he owned a fifty percent equity interest in the stock of Doris Day Distributing Corporation, for which he paid \$150,000. Others present at the meeting also reported hearing this statement, although Strammiello denied making it.³³ Even if the crucial question were (and it was not) whether Mr. Strammiello made the statement rather than whether he owned the stock, it was certainly questionable (before depositions of others present at the meetings had been taken) whether Mr. Greene's testimony would be needed or even helpful. Loeb & Loeb posited that Mr. Greene's testimony would be unnecessary and offered to withdraw if discovery failed to rule out the usefulness of Greene's testimony.³⁴ Faced with the questionable need for Greene's testimony, the trial judge concluded not that Greene ought to testify, but merely that he could not "say with any degree of security or in good conscience that Mr. Greene will not be called as a witness."³⁵ That, probably, was (and is) true of anyone, and certainly of every lawyer involved in the case. The California Supreme Court's finding of no abuse of discretion by the trial court leaves little if any reason for restraint by trial judges.

Other courts have given slightly more guidance on the questions of when a lawyer "ought to testify" and when during the proceeding that question should be determined. At one extreme is the position, recalling the ethical considerations, that every doubt should be resolved in favor of the attorney's testifying, and consequently in favor of disqualification. Under this approach, "[t]he client is entitled to every

31. *Id.* at 916, 576 P.2d at 975, 145 Cal. Rptr. at 13.

32. *Id.* at 913, 576 P.2d at 974, 145 Cal. Rptr. at 12.

33. *Id.*

34. *Id.* at 913, 576 P.2d at 973, 145 Cal. Rptr. at 11.

35. *Id.* (quoting trial court).

scrap of favorable evidence that is available, not only favorable evidence that is *essential* to his case."³⁶ The potential testimony of any attorney-witness with material evidence, whether or not it is duplicative of other testimony, and no matter how far before trial, subjects the attorney and his firm to the withdrawal rule. Thus, one court required each attorney with a case on its docket to notify the court as soon "as it appeared that he or any member of his firm has any testimony that *could conceivably* be used at trial."³⁷

A more moderate position is that the testimony of the lawyer or member of his firm that may be prejudicial to a client need not be absolutely crucial for a disqualification motion to be granted, but neither can it be so insignificant that it raises suspicion that the motion is a tactical artifice or that there is no violation of the policy of the underlying canon.³⁸ This approach leads a court to examine whether the testimony of plaintiff's attorney is genuinely *needed*, rather than just helpful.³⁹ Similarly, it may lead a trial court to delay decision in appropriate circumstances to determine whether the attorney or some other witness should testify.⁴⁰

Yet since the determination whether an attorney's testimony is necessary must be considered on a case-by-case basis, this standard offers little more guidance than did the court in *Comden*.⁴¹ This is particularly true since delaying a decision on disqualification may increase the impact of disqualification if later required.⁴² Since each trial court may apply its own standards (and is left free to do so by the appellate decisions), even if a trial counsel has in good faith determined that no member of his firm will or ought to testify, application of the rule is always possible. As a result, motions to disqualify will remain a vital tactical weapon.⁴³

36. *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1068 (N.D. Tex. 1977) (emphasis in original).

37. *Id.* at 1069 (emphasis in original).

38. *See Freeman v. Kulicke & Soffa Indus., Inc.*, 449 F. Supp. 974, 978 (E.D. Pa. 1978) (applying DR 5-102(B) (which may explain why the position is more moderate)).

39. *J.P. Foley & Co. v. Vanderbilt*, 523 F.2d 1357, 1359 (2d Cir. 1975); *Connell v. Clairol, Inc.*, 440 F. Supp. 17, 18 n.1 (N.D. Ga. 1977).

40. *Miller Elec. Constr., Inc. v. Devine Lighting Co.*, 421 F. Supp. 1020, 1023 (W.D. Pa. 1976).

41. *Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127 (S.D.N.Y. 1978), provides an excellent example of one analysis of the import of an attorney's potential testimony.

42. *Compare Miller Elec. Constr., Inc. v. Devine Lighting Co.*, 421 F. Supp. 1020, 1023 (W.D. Pa. 1976), with *Comden v. Superior Court*, 20 Cal. 3d at 913-14, 576 P.2d at 974, 145 Cal. Rptr. at 12. *But see Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127 (S.D.N.Y. 1978) (delaying disqualification until trial).

43. *See Freeman v. Kulicke & Soffa Indus., Inc.*, 449 F. Supp. 974, 977-78 (E.D. Pa. 1978);

Another important question⁴⁴ faced by courts concerns the applicability of the first exception to DR 5-101(B), which states that the withdrawal rule shall not apply "[i]f the testimony will relate solely to an uncontested matter."⁴⁵ One court has directly considered the applicability of this exception and defined it so narrowly that it is negated altogether.⁴⁶ In that case a lawyer was to testify that his client was ready to close a transaction in a timely fashion. Among other things, the lawyer was to be called to testify to the papers in his briefcase at the appointed time of the closing. As no one else had seen the contents of the briefcase, the lawyer was the only possible witness to this information. Nonetheless, the court held that such testimony went far beyond the "uncontested matters" exception because "his testimony on what was in his briefcase . . . was subject to an attack for credibility."⁴⁷ Obviously, if an attack for credibility suffices to remove the testimony from the purview of the exception, the exception is meaningless.

From the client's perspective, perhaps the most striking question that the courts have dealt with is the applicability of the substantial hardship exception, which provides that the withdrawal rule is inapplicable "[a]s to any matter, if refusal would work a substantial hardship on the client because of the distinctive value of the lawyer or his firm as counsel in the particular case."⁴⁸ Since the client cannot by choice or waiver avoid the imposition of the rule,⁴⁹ the substantial hardship exception is the only aspect of the rule that runs directly in the client's favor.

It should not come as a surprise by this time that the substantial hardship limitation is strictly construed. In the words of one court:

This exception generally contemplates only an attorney who has some expertise in a specialized area of the law such as patents and

Connell v. Clairol, Inc., 440 F. Supp 17, 19 (N.D. Ga. 1977); 20 Cal. 3d at 913, 576 P.2d at 973-74, 145 Cal. Rptr. at 11-12; text accompanying notes 96-98 *infra*.

44. One court has also discussed the issue whether a lawyer is a member of a firm when he is "of counsel," holding it a factual question. J.P. Foley & Co. v. Vanderbilt, 523 F.2d 1357, 1359 (2d Cir. 1975). And the Los Angeles County Bar Association has opined that a lawyer temporarily on leave from a law firm is a member of the firm for purposes of the withdrawal rule. LOS ANGELES COUNTY BAR ASS'N ETHICS COMM., OPINION NO. 367 (1977).

45. DR 5-101(B)(1). A related exception provides that the rule is inapplicable "[i]f the testimony will relate solely to a matter of formality and there is no reason to believe that substantial evidence will be offered in opposition to the testimony." DR 5-101(B)(2). See also DR 5-102.

46. Supreme Beef Processors, Inc. v. American Consumer Indus., Inc., 441 F. Supp. 1064, 1068 (N.D. Tex. 1977).

47. *Id.*

48. DR 5-101(B)(4).

49. Supreme Beef Processors, Inc. v. American Consumer Indus., Inc., 441 F. Supp. 1064, 1068 (N.D. Tex. 1977).

the burden on the firm seeking to continue representation to prove distinctiveness. In addition, the distinctive value must be apparent before the decision to accept or refuse employment is made. Accordingly, the Rule is to be very narrowly construed.⁵⁰

One wonders why, if a lawyer has a particular expertise in a specialized area of the law, this distinctive value must be apparent (and to whom) before the decision to accept or refuse employment is made. Apparently, this additional requirement is added to prevent a firm from acquiring information, either legal or factual, during the course of representing a client and as a result becoming so important to the client that the disqualification of the firm would constitute sufficient hardship. In this way, a firm cannot avoid its ethical obligation to resign by citing the expertise it has acquired in representing the client. As a consequence, the client is not protected against losing the investment he has made in his counsel, except in the rare circumstance in which the firm was uniquely qualified to represent the client before it was hired.

While few cases have discussed the hardship exception in depth, the limited applicability of the exception has been established. Although in one recent case, in denying a motion to disqualify based upon the withdrawal rule, the court focused on the cost of replacing in-house corporate counsel in a relatively small action,⁵¹ the general rule is that neither economic hardship suffered by the client,⁵² who must hire a new law firm that must become acquainted with the case, nor emotional or linguistic hardship is sufficient to invoke the exception. Thus, in one case in which a firm had a ten year history of representing plaintiff and had spent 450 hours in connection with plaintiff's case, the court disqualified plaintiff's counsel on the day of the trial.⁵³ In another case an attorney who could speak Rumanian, the only language the client could understand, who had represented plaintiff's family members for many years, and who had great familiarity with representing Rumanians in general, was disqualified.⁵⁴

50. *Id.* at 1068-69 (citation omitted).

51. *Stanwick Corp. v. United States*, No. 77-115 (U.S. Ct. Cl., filed July 14, 1978).

52. LOS ANGELES COUNTY BAR ASS'N ETHICS COMM., *supra* note 44. It might if this cost threatened to bankrupt the client. Compare FLORIDA BAR ASS'N, ETHICS OPINION 76-26 (1977), with ABA COMM. ON PROFESSIONAL ETHICS, RECENT ETHICS OPINIONS, No. 339 (1975).

53. *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486 (S.D.N.Y. 1976). See also *Stagen Realty & Management, Inc. v. Superior Court*, __ Cal. App. 3d __, 151 Cal. Rptr. 742 (1979); LOS ANGELES COUNTY BAR ASS'N ETHICS COMM., *supra* note 44.

54. *Draganescu v. First Nat'l Bank*, 502 F.2d 550 (5th Cir. 1974). The witness in that case was trial cocounsel, but the court did not attach any significance to that fact. In addition, the

Although courts have been stern in their application of the withdrawal rule, they have been lax in precisely specifying its effects. The typical court order does no more than require counsel to withdraw—it neither provides a deadline for such withdrawal⁵⁵ nor specifies the services that can be performed by the withdrawn counsel.⁵⁶ No court has seriously considered the question of an attorney's subsequent involvement either in the case, as a researcher, investigator, negotiator or tactician, or in the client's other affairs, whether or not directly related to the case. Similarly, no court has considered the effect of trial counsel's or the witness' resignation or absence from the firm as a means of curing the dilemma.⁵⁷ The result is that whatever benefit there is in strict enforcement of the rule may be undermined by the continued involvement of a disqualified firm in the affairs of the client.⁵⁸

II. JUSTIFICATIONS

Few courts have closely examined the rationales for the rule. The lengthy history of the rule disqualifying the trial counsel-witness has lent support and color to the very different situation in which the entire firm is disqualified.⁵⁹

attorney, who had accepted the case on a contingency basis, alleged that other lawyers were reluctant to accept such cases on a contingency basis. Nonetheless, his disqualification was held not to be substantial hardship. *Accord*, *Tru-Bite Labs, Inc. v. Ashman*, 54 App. Div. 2d 345, 388 N.Y.S.2d 279 (1976). *But see* MASSACHUSETTS BAR ASS'N COMM. ON ADMINISTRATION OF JUSTICE, SUBCOMM. ON ETHICS, OPINION No. 75-2 (1975) (suggesting that mental condition of client and his emotional dependence on attorney might constitute substantial hardship).

55. *See, e.g.*, *Comden v. Superior Court*, 20 Cal. 3d at 916-18, 576 P.2d at 976-77, 145 Cal. Rptr. at 14-15. *But see* *Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127, 130 (S.D.N.Y. 1978) (ordering firm's disqualification from representation of client at trial only, and specifically allowing disqualified firm to continue pretrial activities, including court appearances, on behalf of client). *See also* MASSACHUSETTS BAR ASS'N COMM. ON ADMINISTRATION OF JUSTICE, SUBCOMM. ON ETHICS, OPINION No. 75-4 (1975) (suggesting that DR 5-102(A) requires withdrawals only from conduct of *trial*, not litigation).

56. *See* *Draganescu v. First Nat'l Bank*, 502 F.2d 550, 552 (5th Cir. 1974) (suggesting that withdrawn counsel can continue to serve as interpreter).

57. The question of a former member of a firm was delicately avoided in *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288 (2d Cir. 1975). In *J.P. Foley & Co. v. Vanderbilt*, 523 F.2d 1357 (2d Cir. 1975), the court held that the question whether an attorney who was "of counsel" was "in the firm" was a substantial issue of fact. *See also* LOS ANGELES COUNTY BAR ASS'N ETHICS COMM., *supra* note 44 (holding that temporary leave of absence does not suffice to take attorney out of firm).

58. *See* text accompanying notes 68-72 *infra*.

59. For a discussion of the rationales of the rule as they apply or have historically been applied to the trial counsel-witness, see Enker, *The Rationale of the Rule That Forbids a Lawyer to Be Advocate and Witness in the Same Case*, 1977 AM. B. FOUNDATION RESEARCH J. 455; Sutton, *The Testifying Advocate*, 41 TEX. L. REV. 477 (1963); Whitman, *Comment on Recent Decisions of Courts of Last Resort on Ethical Propriety of a Lawyer Appearing as a Witness in Case in Which He Is Acting as Counsel*, 9 A.B.A.J. 123 (1923); Comment, *The Attorney as Both Advocate and Witness*, 4 CREIGHTON L. REV. 128 (1970); Note, *The Ethical Propriety of an Attorney's Testifying*

The ABA Code gives four interrelated reasons for the withdrawal rule:

- (1) If a lawyer is both counsel and witness, he becomes more easily impeachable for interest and thus may be a less effective witness. (2) Conversely, the opposing counsel may be handicapped in challenging the credibility of the lawyer when the lawyer also appears as an advocate in the case. (3) An advocate who becomes a witness is in the unseemly and ineffective position of arguing his own credibility. (4) The roles of an advocate and of a witness are inconsistent; the function of an advocate is to advance or argue the cause of another, while that of a witness is to state facts objectively.⁶⁰

In addition to the four rationales set forth above, courts have interpreted the rule in conjunction with canon 9 of the ABA Code, which provides that "A Lawyer Should Avoid Even The Appearance Of Professional Impropriety."⁶¹

The cornerstone of the rationales presented in the Code is the assertion that the roles of advocate and witness are inconsistent. In the words of the Code, "the function of an advocate is to advance or argue the cause of another."⁶² Yet this is an inaccurate description of attorneys, except, perhaps, litigators at trial. While the words "advocate" and "witness" are rarely used to describe activities outside the litigation context, an attorney representing a client in a negotiation, for example, or in planning a transaction may serve as both representative and prospective witness. This is because the planning attorney should create facts beneficial to his client and state (or more precisely, augment) his client's cause by, for example, discovering a beneficial fact or creating a beneficial contractual provision. At the same time, the attorney should arrange for the preservation of beneficial facts, as by placing himself in an advantageous position to see or hear something.⁶³

in Behalf of His Own Client, 38 IOWA L. REV. 139 (1952); Note, *The Advocate-Witness Rule: If Z, Then X, But Why?*, 52 N.Y.U.L. REV. 1365 (1977); Comment, *The Rule Prohibiting an Attorney from Testifying at a Client's Trial: An Ethical Paradox*, 45 U. CIN. L. REV. 268 (1976).

60. EC 5-9 (numerals added). Three of these reasons assume that the attorney will be a witness on behalf of his client, rather than in opposition to his client.

61. See *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288, 1295 (2d Cir. 1975); *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486, 488 (S.D.N.Y. 1976); *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1354 (D. Colo. 1976); 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

62. EC 5-9; see *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486 (S.D.N.Y. 1976).

63. Thus, while representing the Comdens, Greene placed himself in a position to hear allegedly damaging statements made by his client's potential adversaries. 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

The function of preserving beneficial facts can often be accomplished most simply by a writing, a letter or a contract, and it is often part of an attorney's responsibility to create that writing, and to do so in the most advantageous way for his client. As a result, the attorney may be a witness to the content of that writing, to its intent, to its delivery, or to any reaction to it. Of course, an attorney may also perform this evidence-creating function by attending meetings, or by investigation.

Thus an attorney's role as potential witness is often part of his role as his client's representative. It may be as important as the deal he makes or the contract he drafts, since without his testimony (or the threat of his testimony) the client's position may be weakened or defeated. To expect that the intertwined role of representative and witness will or even can untangle when the matter reaches litigation, so that the attorney can serve as a witness as defined in the Code—to present the facts objectively without any professional interest—is oversimplistic. The attorney fashioned the facts so that as a witness he could objectively put forward his client's (or even ex-client's) position; that is, he structured the situation so that he would be an objective advocate! His client's case and his reputation may still depend on how well he performed that transactional function.

Once this distinction between advocate and witness is impeached, the rationales for the withdrawal rule lose much of their support. The first rationale for the rule presented in the ethical considerations is that "[i]f a lawyer is both counsel and witness, he becomes more easily impeachable for interest and thus may be a less effective witness."⁶⁴ This potential danger is certainly diminished when the attorney-witness himself is not trial counsel but only a member of trial counsel's firm.⁶⁵ Of course, "the opportunity still exists for opposing counsel to argue that the attorney-witness' stake in the litigation as a member of his law firm influences his objectivity";⁶⁶ the disqualified firm's attorney is still eligible to be a witness,⁶⁷ and his impeachability for interest is not

64. EC 5-9. This rationale was cited prominently in both *Comden v. Superior Court*, 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11, and *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 496, 499 (S.D.N.Y. 1976).

65. *Comden v. Superior Court*, 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

66. *Id.*

67. If the question is simply the effectiveness of the attorney as a witness, the client should be the one to make the choice, unless some injury to the judicial process is involved. See *id.* at 918, 576 P.2d at 977, 145 Cal. Rptr. at 15 (Manuel, J., dissenting).

likely to evaporate with his firm's withdrawal from the case. For example, in *Comden*, Loeb & Loeb was disqualified because Marvin Greene ought to be called as a witness. If the case goes to trial and Greene is a witness, he may be impeachable for the following reasons,⁶⁸ all related to his law firm's representation of Comden: (1) the statements that he witnessed occurred during his representation of Comden; (2) as an exercise of his professional judgment, which he (and his firm) would like to see proved correct, he advised Comden to take her present course of action, that is, to file suit; (3) he and his firm still represent Comden in several other related matters; (4) as part of their representation of Comden, he and his firm are still offering suggestions on the handling of this case; and (5) his firm anticipates further payment from the Comdens. Other possible grounds for impeachment, relating to the firm's prior representation, are suggested by the facts of other cases. Perhaps the most devastating to the witness would be that his firm still has a contingent fee riding on the outcome of the case,⁶⁹ or expects a bonus or further business if the transaction that is the subject of the litigation ultimately proves successful.⁷⁰ Or it may be simply that the party previously represented still owes the firm money. In other instances, the attorney-witness might be a legal, business or investment partner of the litigant, or might represent other parties, coplaintiffs or codefendants, in the same case.⁷¹

The fact is that witnesses who at one time represented a litigant are likely to be impeachable for interest for any number of reasons, and forcing their firm to resign from the particular case is not likely to resurrect their credibility. Nor is the rule drafted to achieve this purpose, since it eliminates only one area of impeachment of the testifying attorney—his firm's present representation of the litigant at the trial—and allows the continued involvement of the firm both in the client's affairs that are the subject of the lawsuit and in the client's other business.⁷²

68. Whether, as a matter of the law of evidence, factors of this sort are admissible, we do not here fully explore.

69. See *Draganescu v. First Nat'l Bank*, 502 F.2d 550, 552 (5th Cir. 1974); *Fracasse v. Brent*, 6 Cal. 3d 784, 786, 494 P.2d 9, 10, 100 Cal. Rptr. 385, 386 (1977); *Heinzman v. Fine, Fine, Legum & Fine*, 217 Va. 958, 960, 234 S.E.2d 282, 283 (1977).

70. See *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1067 n.3 (N.D. Tex. 1977).

71. See *Kroungold v. Triester*, 521 F.2d 763, 764 (3d Cir. 1975); *Harrison v. Keystone Coca-Cola Bottling Co.*, 428 F. Supp. 149, 151-52 (M.D. Pa. 1977).

72. The rule is not applicable, for example, if the firm is other than trial counsel, although the witness would be equally impeachable. See *Nakasian v. Incontrade, Inc.*, 78 F.R.D. 229, 232 n.3 (S.D.N.Y. 1978).

The second rationale for the rule set forth in the ethical considerations is that the opposing counsel may be handicapped in challenging the credibility of the lawyer when the lawyer also appears as an advocate in the case.⁷³ This argument, too, loses most, if not all, of its force when the witness is not trial counsel but only a member of trial counsel's firm. As the dissent in *Comden* pointed out:

[I]f the reason underlying disqualification is primarily opposing counsel's difficulty in cross-examining a colleague, surely this handicap will exist whether Loeb and Loeb remains as the representing law firm or is suspended. . . . Defendants have shown no more detriment will occur if petitioners are at that point represented by Loeb and Loeb, than if some other attorney is substituted in. Whatever hesitancy their counsel may have in the cross-examination of a professional colleague will be present in equal force no matter who represents the plaintiff Comdens.⁷⁴

The third rationale presented in support of the withdrawal rule is the unseemly and ineffective position of an advocate who must argue his own credibility.⁷⁵ Yet again, it is not the advocate-trial counsel arguing his own credibility, but a member of the trial counsel's firm. If, as the rule states, the witness cannot effectively argue his credibility, the disqualification of his firm would seem a proper matter of trial tactics rather than ethics. In making the tactical decision the factors to be weighed should include the import to the client of the law firm, the necessity of the lawyer's testimony, and the detriment to that testimony caused by the lawyer's position within trial counsel's firm.

This issue of unseemliness is closely related, or identical, to the last rationale for the withdrawal rule:

[T]he possibility [exists] that testimony by an attorney in the case may lead the public to think "that lawyers may as witnesses distort the truth," thereby diminishing the public's respect for and confidence in the profession. Where doubt may becloud the public's view of the ethics of the legal profession and thus impugn the integrity of the judicial process, it is the responsibility of the court to ensure that the standards of ethics remain high.⁷⁶

73. See *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288, 1294 (2d Cir. 1975); *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486, 489 n.4 (S.D.N.Y. 1976).

74. 20 Cal. 3d at 918-19, 576 P.2d at 977, 145 Cal. Rptr. at 15 (Manuel, J., dissenting). See also *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1353 (D. Colo. 1976) (pointing out that ethical duty to represent client competently and zealously easily outweighs professional hesitancy in cross-examining colleague).

75. See *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486, 489 (S.D.N.Y. 1976).

76. *Id.* at 489; see *Comden v. Superior Court*, 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal.

The argument that the public's respect for and confidence in lawyers may be diminished by its view of the testifying advocate is grounded principally in two commonly presented fictions, both of which are reiterated in the Code: witnesses are supposed to be neutral observers of fact; and lawyers should avoid being witnesses because the role of a lawyer and that of a witness are antithetical.⁷⁷ The first of these is long discredited. American courts permit and even encourage partisans to be witnesses and allow the impeachment of witnesses, with the expectation that the judge or jury will evaluate the testimony in the light of the witnesses' interest.⁷⁸ The second fiction is, as already explained, equally fallacious—the attorney's role may in part be to make himself a witness.

What is unseemly, then, is the Code's sanctification of these fictions as part of the lawyer's ethics. What is likely to reduce public confidence in lawyers and legal ethics is the rule's existence, because it emphasizes the impeachability and even the untrustworthiness of lawyers' testimony, and because it calls for enforcement, which is no more than a public display that lawyers do not abide by their own ethical code.⁷⁹ Thus the rule is self-perpetuating: it is unseemly for an attorney whose firm is trial counsel in the case to testify *because* there is a rule of ethics to the contrary.

III. THE CLIENT

The withdrawal rule makes no distinction between various clients. At least as it is written and has been interpreted, the rule applies equally to all clients. No client, no matter how sophisticated, can waive

Rptr. at 11. In this regard, however, the court in both *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288 (2d Cir. 1975), and *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348 (D. Colo. 1976), warned against taking the view of the most cynical as the voice of the public. 527 F.2d at 1294; 421 F. Supp. at 1353. Although the court in *United States ex rel. Sheldon Elec. Co. v. Blackhawk Heating & Plumbing Co.*, 423 F. Supp. 486 (S.D.N.Y. 1976), found this to be the most persuasive rationale for the disqualification, at least in a nonjury case, it did not suggest what member of the public would lower his estimation of lawyers. 423 F. Supp. at 489-90. It seems that the client, as the member of the public with the most at stake, is likely to be offended that he cannot waive the withdrawal rule, but rather must make his own sacrifices for the public relations of the legal profession.

77. EC 5-9.

78. See *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1354 (D. Colo. 1976).

79. This is not to suggest that violations of the ethical code should go unpunished. When rules of ethics are unnecessary to protect the client or the profession, however, there is no purpose in enforcing them except for discipline's sake.

application of the rule.⁸⁰ Because the rule focuses on the lawyer, it misses what may be important distinctions between clients. Clients are different in a number of ways that may require different analyses of the rule. Some clients seek the services of a lawyer only for a particular matter in a crisis situation. This is the customary situation with middle to low income persons who see a lawyer only when faced with an immediate legal problem, usually in the litigation context, often because they have been involved in a tort or have been arrested. Usually no great harm to the client results if the lawyer first selected declines the representation.⁸¹ As long as there are a sufficient numbers of lawyers in the community, another may be found. Yet even in these situations, when the attorney has no pre-existing relationship with the client, and the client seeks legal help only with a particular litigation matter, a shift of lawyers is likely to be disquieting to the client. The lawyer who has investigated with the client the factual circumstances of the case, who has begun to communicate effectively with the client, and who has gained the client's confidence must be replaced by a stranger.⁸² Another problem that may be caused by disqualification is the disruption of the fee arrangement. In contingent fee situations, some split of the contingency, or other formula, may be used to determine the compensation of successive lawyers.⁸³ The first lawyer is certainly entitled to some recovery, whether measured by quantum meruit or another theory, if he did substantial work before it became apparent that he ought to be a witness.⁸⁴ As a result it may be difficult, or at least costly, to find subsequent counsel.⁸⁵

80. The one exception to this is an attorney-litigant who represents himself *pro se*, or who has his own firm represent him. See text accompanying note 87 *infra*.

81. The client's statements to the attorney, even though the engagement does not materialize, are protected by confidentiality, so the client is not prejudiced.

82. To some people unaccustomed to dealing with lawyers, hiring a lawyer is traumatic; and being forced to repeat the process may mean more than recurring trauma, it may cause the client to forsake his claim.

83. In some instances, a dispute may arise concerning the issue whether the disqualification was foreseeable and thus whether the lawyer was at fault. A lawyer at fault would not be entitled to share.

84. *Fracasse v. Brent*, 6 Cal. 3d 784, 791, 494 P.2d 9, 14, 100 Cal. Rptr. 385, 390 (1972).

85. *E.g.*, *Draganescu v. First Nat'l Bank*, 502 F.2d 550, 552 (5th Cir. 1974) (client's language barrier created difficulty in retaining subsequent counsel); *cf.* *Stanwick Corp. v. United States*, No. 77-115 (U.S. Ct. Cl., filed July 14, 1978) (corporate counsel not disqualified; additional expense of employing outside counsel not justified). This problem may be heightened because lawyers who take cases on a contingency often do so partly because of the likelihood of settling at an early stage in the proceedings. A lawyer, of course, cannot withdraw if the matter does not settle profitably. DR 2-110. Ironically, only a forced resignation might make the situation profitable, or at least less costly for the disqualified lawyer who took the case expecting to turn a profit on a settlement only to find a settlement unobtainable.

The client such as the typical entrepreneur who approaches a lawyer seeking broad-based representation presents different problems. This client is most interested in developing a lasting relationship with the attorney. He sees the attorney's function as a general problem solver, rather than as an advocate in a particular situation. He is likely to keep the attorney on retainer, so that the attorney will be knowledgeable about his affairs and available both for day-to-day matters and whenever an emergency arises. Since he is likely to view his relationship with his attorney as a business investment, the firm's disqualification, even for a particular case, may not only be costly in the particular case, but may destroy or damage an important business asset. When the firm is disqualified, or resigns, the client may start over again with a new firm or, more likely, retain the disqualified firm as his firm for other matters and even, to the extent allowed, as a consultant with respect to the case on which the firm member will be a witness.⁸⁶

Perhaps the most interesting dilemma is when the client and lawyer are identical or, like Siamese twins, inseparable. One such problem is the lawyer who represents himself. To some extent, the rationale of preserving the integrity and unimpeachability of lawyers applies more strongly to the lawyer representing himself, since he is more impeachable for interest, and therefore potentially more embarrassing to the profession, than the lawyer who is a witness to the affairs of a client. At least one case has held, however, that a lawyer who is a party and ought to testify may be represented by his own firm.⁸⁷

A more important situation in which lawyer and client are identical occurs in the cases of corporate counsel and government law offices. While the rule is applicable to such situations, the purposes of the rule are not served by preventing corporate counsel or government law offices from being involved in litigation. In spite of withdrawal, corporate counsel is likely to be intimately involved with the trial process, and the witness is likely to remain impeachable for interest because he is the agent of (and his personal livelihood is dependent upon) the client. Thus, the result of the disqualification of corporate counsel is to

86. This was the case in *Comden*. 20 Cal. 3d at 916, 576 P.2d at 976, 145 Cal. Rptr. at 14 (Manuel, J., dissenting).

87. *Harrison v. Keystone Coca-Cola Bottling Co.*, 428 F. Supp. 149 (M.D. Pa. 1977); VIRGINIA STATE BAR, LEGAL ETHICS INFORMAL OPINION NO. 114; NEW YORK STATE BAR ASS'N COMM. ON PROFESSIONAL ETHICS, OPINION NO. 353 (1974). In *Harrison*, the court disqualified the firm involved from representing a codefendant; thus the court's decision resulted in both the impeachment of an interested lawyer and the cost to one client of replacing that same lawyer. The court did not investigate how much more impeachable the lawyer-witness would have been if his firm had been allowed to continue its representation of its partner's codefendant.

require the corporation to incur the expense of having outside counsel without protecting the client or the judicial process.⁸⁸

In this era of the taxpayer's revolt, it is perhaps more shocking that government firms, such as district attorneys, have been disqualified under the rule if a lawyer in the office ought to be a witness in a trial.⁸⁹ The expense involved in disqualifying government offices involved with criminal matters, while certainly substantial, may be exceeded by the cost of the disqualification of government civil law offices. Since these offices often negotiate agreements as well as handle any ensuing litigation, the rule will apply in a large percentage of such an office's litigation. While such agencies may try to avoid the application of the rule in the future by dividing into a nonlitigation and a litigation firm, this nominal change in structure will either be disregarded by courts or expose how flimsy are the rule's underlying rationales.

IV. THE LAWYER AND THE LAWYERING PROCESS BEFORE LITIGATION IS CONTEMPLATED

The withdrawal rule by its terms does not apply until there is contemplated or pending litigation. Nonetheless, the rule may have a profound effect on the lawyer and the lawyering process before a dispute arises. This, in part, is because much, if not most, predispute lawyering anticipates some dispute resolution machinery, whether arbitration⁹⁰ or trial. The lawyer structures the client's affairs so that, if necessary, a court or other dispute resolver will vindicate his client. Because, in this sense, the lawyer always contemplates the possibility of litigation, he must consider the effect of the rule if litigation develops.

88. Partly for this reason, the court in *Stanwick Corp. v. United States*, No. 77-115 (U.S. Ct. Cl., filed July 14, 1978), did not require withdrawal, although the court implied that in appropriate circumstances, such as when the additional expense would be more defensible, corporate counsel might be disqualified from acting as trial counsel. See *Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127, 130 (S.D.N.Y. 1978). But see *Gasoline Expressway, Inc. v. Sun Oil Co.*, — App. Div. 2d —, 407 N.Y.S.2d 64 (1978); FLORIDA BAR ASS'N COMM. ON PROFESSIONAL ETHICS, OPINION No. 76-26 (1977) (rule applied when attorney was stockholder, vice president and attorney for corporation); LOS ANGELES COUNTY BAR ASS'N ETHICS COMM., *supra* note 44.

89. See *People v. Superior Court*, 19 Cal. 3d 255, 561 P.2d 1164, 137 Cal. Rptr. 476 (1977); *People v. Lopez*, 79 Cal. App. 3d 963, 145 Cal. Rptr. 294 (1978) (withdrawn from publication by order of court); Letter from Albert Bell, Counsel, Ohio State Bar Association, to John J. Adams, Law Director, City of Kettering (March 20, 1978). That the attorney testified may not prevent defendant from obtaining a fair trial. *People v. Guerrero*, 47 Cal. App. 3d 441, 120 Cal. Rptr. 732 (1975); *State v. Johnson*, 224 Kan. 466, 580 P.2d 1339 (1978); *Harris v. State*, 78 Wis. 2d 357, 254 N.W.2d 291 (1977).

90. The rule does not on its face apply to administrative proceedings or to arbitrations, except perhaps to the extent that litigation following the proceedings is contemplated. If the major purpose of the rule is to protect the image of lawyers by relieving them from one area of impeachment, the rule would seem equally applicable to such proceedings.

Without the rule, for example, the lawyer may worry about the effect of writing a demand letter or making a demand. With the rule, the lawyer also needs to evaluate the legal, tactical and extra-legal effect of writing the letter or attending the meeting. The legal effect of the rule is the resulting disqualification of the firm if the rule is applicable. The tactical effect of the rule, which we will investigate later, is simply the disadvantage of raising an issue of the applicability of the rule in any subsequent litigation. The extra-legal effect of the rule is its impact on the ability of the firm, and of lawyers in general, to render good, cost-efficient legal services to the client. This evaluation of the extra-legal impact of the rule must necessarily take into account the value of the firm's general representation of the client, the detriment to the client of the firm's disqualification from the particular litigation, and the impact of and harm to the attorney-client relationship. While the impact of the rule in particular situations is unclear, its impact on the predispute lawyering process is unmistakable. One court identified the hardship to the client who later becomes embroiled in litigation in the following way:

One reason for maintaining a continuing relationship with a lawyer or law firm is to prevent the difficulty which would ensue if each time litigation was commenced a new attorney would be required to familiarize himself with the client and its business. The advantages of preventive law, like preventive medicine, is [*sic*] well recognized through this profession as a means of settling business problems before they require expensive and time-consuming litigation. A client who desires to head off a court battle should not be penalized for having the foresight to employ legal counsel before the commencement of a lawsuit. Requiring a litigant to change counsel when a suit is filed surely causes some degree of hardship.⁹¹

As the rule comes to be more frequently applied by courts and followed by practitioners of their own volition, the advantages of seeking legal help for incipient transactions may be reduced. Indeed, clients with a

91. *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1352 (D. Colo. 1976). See also *Comden v. Superior Court*, 20 Cal. 3d at 916, 576 P.2d at 976, 145 Cal. Rptr. at 14. Some may urge that when litigation results, the preventive law performance of the lawyer was inadequate, so that substitution of counsel does not harm the preventive law concept. Preventive law lawyering does endeavor to maximize legal opportunities and also to minimize the risk of later legal trouble, but it does not necessarily fail if litigation results. In transactional and other nonadversarial matters predictable trouble can often be eliminated, but at the cost of giving up too much at early preventive law stages. For example, an ambiguous contract may lead to foreseeable litigation. That litigation could have been avoided by an unambiguously worded contract, but the cost of clarity may be greater than the cost of litigation. See generally L. BROWN & E. DAUER, *PLANNING BY LAWYERS: MATERIALS ON A NONADVERSARIAL LEGAL PROCESS* (1978) (especially chs. 6 and 7).

particularly valuable relationship with their attorneys may be advised to carefully limit the attorneys' roles in such transactions.

A more subtle but perhaps more harmful effect of the rule is its impact on the lawyering ability of a preventive lawyer. The rule not only interferes with the attorney-client relationship but impairs one of the preventive lawyer's most useful techniques, making himself an administrator-witness who enforces or maximizes his client's rights. When possible, the preventive lawyer wants to perceive the contractual breach, or to investigate the tort. He does so not only because he can do it better than the client, but because it puts him in a better position to negotiate a settlement, since he can gauge more precisely the strength of his client's prospective case if litigated, and since he can ensure that his client will have a good witness. And, contrary to popular belief, the lawyer often makes a very good witness, not because of his courtroom manner, however good or bad, but because the lawyer knows *what* to witness.

Once the lawyer-client relationship is established, the harm inherent in the withdrawal rule becomes more apparent (but not necessarily more real) as the transaction moves closer and closer toward litigation. As litigation looms nearer it becomes more likely that counsel will, in fact, resign or be disqualified from the litigation if a member of his firm is a witness. As a result, counsel must become increasingly circumspect about how his firm is involved, and what it witnesses, in the course of representation.

In the future a lawyer may refuse to engage in settlement negotiations⁹² or factual investigations because of the possibility that, as a result of his participation, he might become a witness and thereby at a minimum give his opponent a new tactical weapon in any ensuing litigation. As a result, settlement negotiation might not take place, or the lawyer might abdicate some of his traditional functions by having a nonlawyer (often the client) conduct settlement discussions and factual investigations to insulate the firm from the application of the rule. Thus the rule, by interfering with the lawyer-client relationship, by limiting the usefulness of legal planning in the early stages of a transaction, by interfering with the techniques used by preventive lawyers, and by encouraging nonlawyers to succeed to functions traditionally performed by lawyers, would often result in poorer representation, and

92. As is evident from the *Comden* case, the possibility of disqualification is not cured just because settlement negotiations may be privileged. 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

ironically might deter a settlement that would, among other things, have avoided the application of the rule.⁹³

V. THE LITIGATION CONTEXT

While the rule has an impact on lawyering even before there is a dispute, and a firm may have to withdraw from or decline representation as soon as litigation is contemplated, the initiation of litigation remains the crucial step in the application of the withdrawal rule. Not until a suit has been filed does a court have the right to apply the rule by requiring disqualification. Because from the moment of the filing of the suit the court process anticipates the eventual trial, it seems logical that the rule may require disqualification of a firm as soon as suit is filed.⁹⁴ But because the rule is aimed only at preventing an attorney from testifying, which can occur only at trial, and since relatively few cases, once filed, proceed to a trial on the merits, enforcing the rule as soon as suit is filed results in unnecessary disqualification, and thus inconvenience and expense, in a great number of cases.⁹⁵

Because the rule is applicable and the court, as enforcer, is present, the tactical value of the rule flowers when a dispute enters the litigation context, a fact that has not been ignored by courts. As the court noted in *Comden*: "It would be naive not to recognize that the motion to disqualify opposing counsel is frequently a tactical device to delay litigation."⁹⁶ But while the courts have not been blind to the tactical value of the rule, neither have they fully considered it. Even in the most usual circumstances, the tactical use of the rule may be more varied than just to delay the litigation. There may be tremendous advantage

93. We do not mean to imply that the rule itself fosters litigation. By being a tactical weapon, it may favor one side or the other, but this can be taken into account in reaching a settlement. But to the extent that it results in nonlawyers drafting documents and deters lawyers, skilled negotiators, from engaging in settlement discussions, it is likely to increase litigation.

94. *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064 (N.D. Tex. 1977), required attorneys "to notify court as soon as it appears that they or members of their firms have any testimony that *could conceivably* be used at trial." *Id.* at 1069 (emphasis in original).

95. This unnecessary expense could be avoided, at least in part, by adopting the approach of the court in *Norman Norrell, Inc. v. Federated Dep't Stores, Inc.*, 450 F. Supp. 127 (S.D.N.Y. 1978), which did not require withdrawal of the disqualified firm until trial. This result, while certainly preferable to early disqualification, may seriously affect settlement, even if the case does not go to trial, by giving the disqualified firm's adversary a decided edge because late disqualification itself may be prejudicial or at least detrimental to the client. See *Miller Elec. Constr., Inc. v. Devine Lighting Co.*, 421 F. Supp. 1020, 1023 (W.D. Pa. 1976).

96. 20 Cal. 3d at 915, 576 P.2d at 975, 145 Cal. Rptr. at 13; see *Connell v. Clairol, Inc.*, 440 F. Supp. 17, 19 (N.D. Ga. 1977).

in disqualifying the opposing counsel. As indicated, in some circumstances new counsel may be unobtainable. In other cases, the expense incurred in hiring new counsel may be significant, even if not a "substantial hardship." Even when the motion will eventually be lost, there may be an economic incentive to make a disqualification motion because the cost to the opponent of waging the battle may be quite large—in one case the designation of record for the motion alone contained nearly 1,000 pages.⁹⁷ In addition, while an opponent's attention is focused on the motion, action on the merits may be delayed.⁹⁸ Thus a party might use the motion to control the tempo of a lawsuit. The existence of the rule also may open the scope of discovery to permit, or even require, discovery centered on whether the attorney ought to be a witness. Further, because delaying decision on a disqualification motion may increase the prejudice to the client, this discovery might properly be expedited in some circumstances. Discovery, of course, would be a perfect vehicle for harassing the opposing firm by taking depositions of all attorneys involved, in the hope of discovering at least one potential witness. In other circumstances, attorneys may wish to avoid disqualification of their counterparts. The reasons for this may range from a particularly good working relationship to the hope that the attorney-witness will be more easily impeached, and thus his testimony rendered less harmful.⁹⁹

While the trial court has the authority to raise the applicability of the rule on its own motion,¹⁰⁰ it will rarely be in a position to do so unless the attorney testifies, submits an affidavit, or is listed as a potential witness at the pretrial, or unless the issue is otherwise brought to the court's attention. Thus, while it may be an attorney's ethical duty

97. *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348, 1351 (D. Colo. 1976). In a modest effort to ascertain data about the costs involved, we requested information from some lawyers involved in reported cases. The replies we received are that cost of the motion was: "\$10,000"; "\$9,000"; "difficult to segregate"; "difficult to quantify—estimate \$3,500"; "twenty to thirty hours"; "with appeal \$10,000"; "approximately \$3,045, including the appeal"; "not available"; "\$3,500 plus the cost of the transcript of my testimony, which was probably five or six hundred dollars."

98. *See Miller Elec. Constr., Inc. v. Devine Lighting Co.*, 421 F. Supp. 1020, 1023 (W.D. Pa. 1976). For this reason, the firm that successfully fought a motion to disqualify in *Greenebaum-Mountain Mortgage Co. v. Pioneer Nat'l Title Ins. Co.*, 421 F. Supp. 1348 (D. Colo. 1976), advised its client to hire new counsel rather than delay trial on the merits to await the outcome of the appeal of the disqualification motion. Note, *The Advocate-Witness Rule: If Z, Then X, But Why?*, *supra* note 59, at 1380 n.88.

99. *See Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1067 (N.D. Tex. 1977).

100. *Id.* at 1067; *Stagen Realty & Management, Inc. v. Superior Court*, — Cal. App. 3d —, 151 Cal. Rptr. 742 (1979).

to bring to the attention of the court possible violations of the Code of Professional Responsibility, an attorney may intentionally overlook the applicability of the rule or may attempt to agree with opposing counsel not to raise the issue in exchange for some concession.¹⁰¹

The more the rule is used as a tactical device, the greater the cost both to the client and to the judicial system. While the cost of the rule to the client may seem paramount, the cost to the judicial system should not be ignored. Because, like other procedural matters, the disqualification motion is collateral to the core of the dispute between the litigating parties, bringing the motion is unlikely to bring the litigation to a halt, or to reduce the expense or complexity of the litigation process, although responding to a disqualification may consume much judicial time and energy. Even when the motion is successful and a firm is forced to resign, the case continues. Indeed, the added cost and delay incurred while the new attorneys become acquainted with the action may significantly increase a court's burden.¹⁰²

VI. SUGGESTIONS

In sum, the withdrawal rule does not serve the client, the lawyer or the judicial process. The rationales for the rule are flimsy even when applied to the nondifferentiated client and attorney relationship. Applied to the myriad of different attorney-client relationships, the rule is often counter-productive because it interferes with the lawyer-client relationship, with lawyering and with the judicial process, and does so unnecessarily in the vast majority of situations that do not result in a trial. The rule is presented as a matter of ethics, rather than economics, and therefore does not purport to be practical. Courts and legislatures have accepted and implemented it without scrutinizing either the rationales that supposedly underlie it, or any empirical data showing that the rule is important to the standing or reputation of the profession. In this sense, enforcing the rule to protect the "public trust within the scrupulous administration of justice and in the integrity of the bar"¹⁰³ may be a pyrrhic triumph.

101. See, e.g., *United States v. McKoy*, 448 F. Supp. 826 (E.D. Pa. 1978).

102. See *Ross v. Great Atl. & Pac. Tea Co.*, 447 F. Supp. 406 (S.D.N.Y. 1978) (court noted delay and congestion that would result if counsel were disqualified).

103. *Comden v. Superior Court*, 20 Cal. 3d at 915, 576 P.2d at 975, 145 Cal. Rptr. at 13 (quoting *Hull v. Cellanese Corp.*, 513 F.2d 568, 572 (2d Cir. 1975)); see *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1068 (N.D. Tex. 1977).

At least in California, the rule has been the subject of much discussion since the *Comden* decision. The California State Bar has recently proposed amending the California version of the rule to, among other things, eliminate the effects of the *Comden* decision by making the rule inapplicable to law firms as distinguished from individual lawyers in a firm. This approach avoids the difficulties of the rule's application to various clients at various times, as well as the difficulties inherent in applying ethical standards in the context of ongoing litigation to which any ethical violation is collateral. Consequently, this approach would avoid most tactical applications of the proposed rule and the concomitant impact on practice.¹⁰⁴

If there is unethical conduct, in the true as well as the codified sense, then the attorney rather than the client should directly bear the consequences. A bar disciplinary hearing is a more equitable forum to mete sanctions upon the attorney than is the court of the ongoing litigation.

Although we believe that the revocation of the rule is appropriate, we recommend that in practice a lawyer inform his client in as much detail as possible about the detriment of continuing representation when a member of the firm will¹⁰⁵ or may testify, so that the client can determine if the continued representation would be beneficial. Obviously the less sophisticated the client, the more detailed should be the lawyer's explanation, and the more the lawyer should suggest that the client consult independent counsel on this question alone. With certain clients who are or contain their own legal staffs, such as corporate counsel, asking the question may suffice to answer it.

The question of the testifying firm member should be considered one of attorney competence and attorney-client relations. Thus, rather than appearing under canon 5, which is aimed principally at conflicts of interest, the requirement that a lawyer inform a client of the effects of his continued representation if a firm member may be a witness might appropriately appear as a corollary to canon 6 of the Code,

104. The previous proposal made the client's consent to a firm's continued representation a subject before the court, and as a result entailed continued judicial involvement in the applicability of the rule and in such issues as the substance and understanding of the client's waiver. Report and Recommendations of the State Bar of California Board of Governors Committee on Lawyer's Services, Appendix B, Proposed Amendments to the Rules of Professional Conduct, Rule 2-111(A)(4) (December 28, 1978).

105. Here, since the attorney and client rather than the court are determining who will testify, the question can be actual rather than speculative.

which provides that "A Lawyer Should Represent A Client Competently." Explaining the detriment of one's firm's continued representation is one aspect of competent representation, just as declining employment when one's particular legal skills are deficient is an aspect of competent representation.¹⁰⁶ This should eliminate the use of the rule as a tactical weapon; it should also reduce the enormous costs of the rule, both direct and indirect, not only in the planning stages of a transaction, but in all stages of the litigation.

We have in the past criticized the Code because of its unresponsiveness to preventive practices.¹⁰⁷ We see the rule as another illustration of a system of ethics that ignores the *sine qua non* of the legal profession—the client¹⁰⁸—and speaks, out of habit, of legal practice as courtroom practice. While the rule is indeed harmful to the profession and, we believe, to public confidence in the profession, the Code's failure to portray accurately lawyers and the practice of law, and its perpetration and public espousal of myths, such as the inconsistency of being both advocate and witness, may ultimately prove even more harmful. The Code should be reexamined and rewritten so that legal ethics as codified serve the public and client, in the general rather than the specific sense, and reflect—indeed, if possible, enhance—the myriad ways in which the modern lawyer serves the client and society.¹⁰⁹

106. DR 6-101(A)(1). Competent representation may include more than this one instance of informed participation by a client. We believe that the Code has distorted the proper attorney-client relationship in the planning context and minimized the role of the client. See Brown & Brown, *What Counsels the Counselor, The Code of Professional Responsibility's Ethical Considerations—A Preventive Law Analysis*, 10 VAL. U.L. REV. 453 (1976).

107. See Brown & Brown, *supra* note 106.

108. A voice in the wilderness, *Stanwick Corp. v. United States*, No. 77-115 (U.S. Ct. Cl., filed July 14, 1978), states clearly that, in the opinion of that court, the rule is for the benefit of the client. This contrasts with the prevalent view, at least in reported opinions, that the rule exists for the protection of the bar and of the integrity of the court, as well as for the clients. See, e.g., *Supreme Beef Processors, Inc. v. American Consumer Indus., Inc.*, 441 F. Supp. 1064, 1068 (N.D. Tex. 1977). In our opinion, that philosophical approach, more than any substantive distinction (although there were some), explains why that court construed the rule more liberally than other courts, and refused to disqualify counsel.

109. See Wolfram, *Barriers to Effective Public Participation in Regulation of the Legal Profession*, 62 MINN. L. REV. 619, 646 (1978) ("lawyers as a profession are uniquely insulated from the normal workings of the political process").



CONFIDENCES AND THE GOVERNMENT LAWYER

ROBERT P. LAWRY†

At least since Philip Shuchman's 1968 polemic¹ on the propriety of the former Canons of Ethics as a group moral code, the aptness of having the same rules and standards govern the activities of all lawyers and all lawyering jobs has been in question. Considerable differences exist among the kinds of ethical problems encountered by lawyers doing probate work or criminal work, negotiating a contract or trying a law suit, practicing with a corporation, a government agency, a law firm or on their own. The question is whether there ought to be different ethical rules and standards governing the behavior of lawyers, depending on the type of legal problem involved, the type of client being served, and the nature of the lawyer's practice. I believe the answer to that question is clearly "yes."² Broad ethical principles have been espoused without careful, differentiated rule drafting to reflect the true nature of the problems lawyers encounter in practice. Thus, the fit is either awkward or there is no fit at all.

I would not be misunderstood on the scope of the changes I believe necessary. There certainly is enough that is similar in lawyering

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1. Shuchman, *Ethics and Legal Ethics: The Propriety of the Canons as a Group Moral Code*, 37 GEO. WASH. L. REV. 244 (1968). For a brief historical account of the origins of the former Canons, see H. DRINKER, *LEGAL ETHICS* 23-24 (1953).

2. In distinguishing between lawyers who practiced with "big law firms" (BLFs) and the "little lawyers" (LLs) of the world, Professor Shuchman made a similar point: "(1) [T]he activities [of the two groups] are very different (2) but perhaps not enough so that different labels should be used (3) yet quite enough so that there should be two sets of rules (4) which should be drawn by the different groups." Shuchman, *supra* note 1, at 266. I do not subscribe to this category of propositions. I simply agree with Shuchman that there are sufficiently different lawyering activities to warrant separate rules. For example, with respect to his fourth proposition, I think it would be disastrous for each "special" group to draft the rules that apply to them. That would likely result in selfishly conceived rules all around. What the profession needs is a wider range of people assisting it in drafting its rules. Of course, we also need to have a good deal of input from each special group in order to understand from the insider's perspective what the "real" problems are.

The Final Report of the Seventh Annual Chief Justice Earl Warren Conference on Advocacy in the United States goes part of the way in endorsing the view expressed in the text. Recommendation B states: "The Code of Professional Responsibility should be redrafted to incorporate standards of conduct applicable to specialty fields within the practice of law." ROSCOE POUND-AMERICAN TRIAL LAWYER'S FOUNDATION, *ETHICS AND ADVOCACY* 10 (1978).

under any set of circumstances to warrant many identical rules and standards. If this were not so, it would be impossible to talk of lawyers as having membership in a single profession.³ Nevertheless, I believe those who draft the ethical rules and standards too often labor under certain unconscious assumptions that tend to blur important distinctions between lawyer and lawyer, law job and law job.⁴ These assumptions are based not only on historical anomalies,⁵ but are also sometimes based on deeply-felt, if often unarticulated beliefs about the nature of the adversary system⁶ or about the nature of lawyering generally.⁷ These assumptions are often simply the result of a lack of adequate conceptualization and rigorous thinking.

This article is an attempt to uncover one such assumption, embedded deeply in many provisions of the present Code of Professional Responsibility, and to demonstrate how utterly impossible it is to utilize the Code in attempting to deal with the serious problems many of those same provisions were ostensibly designed to aid the lawyer in handling. The assumption is that a lawyer's client is a "readily-identifiable-human-being." I do not mean to suggest that the draftsmen of the present Code were not aware of so-called "entity" representation.⁸ What I do mean is that this largely unconscious assumption guided the hands of the draftsmen and currently produces wholly unworkable results in too many very important instances. The context for the discussion of this assumption is the perplexing problem of confidentiality for the government lawyer. While being extremely concrete in addressing this problem, even to the point of suggesting specific changes in the Code of Professional Responsibility, my hope is that the larger issue of the inaptness of having a single set of ethical standards to govern all the various roles that lawyers fulfill, will not be lost as Philip Shuchman's similar point was lost in the promulgation of a new Code a scant year

3. See R. POUND, *THE LAWYER FROM ANTIQUITY TO MODERN TIMES* 4-10 (1953).

4. For example, in discussing the advertising question nearly 10 years before *Bates v. State Bar*, 433 U.S. 350 (1977), Professor Shuchman exposed one long-standing assumption of the profession: "The assumption that a good reputation will produce the unsolicited recommendations of others and lead to a satisfactory and stable practice *may* have been warranted sixty years ago, but for most LL's in most urban areas, a neighborhood reputation is a meaningless thing, a chimera." Shuchman, *supra* note 1, at 253.

5. See H. DRINKER, *supra* note 1, at 210-15.

6. See, e.g., Frankel, *From Private Fights Toward Public Justice*, 51 N.Y.U.L. REV. 516, 516-22 (1976). Judge Frankel calls the adversary system "The Adam Smith System of Adjudication."

7. See, e.g., Curtis, *The Ethics of Advocacy*, 4 STAN. L. REV. 3, 5 (1951). Curtis says that on behalf of his client, a lawyer "is required to treat outsiders as if they were barbarians and enemies."

8. See EC 5-18; ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 86 (1932).

after the appearance of his important article.⁹

I

The draftsmen of the Code did recognize that the government lawyer has obligations that differ from those of other lawyers. DR 7-103 specifically sets forth two rules that are to guide the government lawyer involved in criminal matters: DR 7-103(A) requires that the government lawyer not institute criminal charges unless those charges are supported by probable cause;¹⁰ and DR 7-103(B) requires the government lawyer to disclose favorable evidence to the criminal defendant.¹¹ These two provisions imply that the government lawyer has a duty to "justice," or at least to "fairness,"¹² that the ordinary lawyer does not have. Indeed, the ethical considerations supporting these two provisions expressly substantiate this implication. EC 7-13 states: "The responsibility of a public prosecutor differs from that of the usual advocate; his duty is to seek justice, not merely to convict."¹³ EC 7-14 states: "A government lawyer who has discretionary power relative to litigation should refrain from instituting or continuing litigation that is obviously unfair." Furthermore,

9. At the time he was writing, Shuchman predicted the new Code would be *déjà vu*. Shuchman, *supra* note 1, at 248 n.10.

10. The ABA STANDARDS FOR THE PROSECUTION FUNCTION (Approved Draft 1971) offer some additional guidance on this problem in § 3.9, which has been interpreted by Professor Richard Uviller as meaning that a "prosecutor *must* abjure prosecution without probable cause, *should* refuse to charge without a durable prima facie case, and *may* decline to proceed if the evidence fails to satisfy him beyond a reasonable doubt." Uviller, *The Virtuous Prosecutor in Quest of an Ethical Standard: Guidance from the ABA*, 71 MICH. L. REV. 1145, 1156 (1973). For a view that the prosecutor's duties are even higher than Uviller believes them to be, see M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 84-88 (1975).

11. This duty is closely connected to the due process requirements announced by the Supreme Court in *Brady v. Maryland*, 373 U.S. 83, 87 (1963). See also *Moore v. Illinois*, 408 U.S. 786 (1972).

12. EC 7-13, -14.

13. The whole provision reads as follows:

The responsibility of a public prosecutor differs from that of the usual advocate; his duty is to seek justice, not merely to convict. This special duty exists because: (1) the prosecutor represents the sovereign and therefore should use restraint in the discretionary exercise of governmental powers, such as in the selection of cases to prosecute; (2) during trial the prosecutor is not only an advocate but he also may make decisions normally made by an individual client, and those affecting the public interest should be fair to all; and (3) in our system of criminal justice the accused is to be given the benefit of all reasonable doubts. With respect to evidence and witnesses, the prosecutor has responsibilities different from those of a lawyer in private practice: the prosecutor should make timely disclosure to the defense of available evidence, known to him, that tends to negate the guilt of the accused, mitigate the degree of the offense, or reduce the punishment. Further, a prosecutor should not intentionally avoid pursuit of evidence merely because he believes it will damage the prosecutor's case or aid the accused.

EC 7-13.

A government lawyer in a civil action or administrative proceeding has the responsibility to seek justice and to develop a full and fair record, and he should not use his position or the economic power of the government to harass parties or to bring about unjust settlements or results.¹⁴

Although the ethical considerations are "aspirational in character" and are not "mandatory," they do "represent the objectives toward which every member of the profession should strive."¹⁵ Though the problem is serious, it is not necessary to quarrel at this point with the inconsistencies that plague the Code in its attempt to maintain this aspirational/mandatory distinction;¹⁶ it is sufficient to note the clear references to different duties on the part of the government lawyer "from that of the usual advocate."

The latter's duties are often considered to be exclusively dischargeable on behalf of the client. Indeed, in Lord Brougham's ringing words: "'An advocate, by the sacred duty which he owes his client, knows, in the discharge of that office, but one person in the world, THAT CLIENT AND NONE OTHER.'"¹⁷ Whether these words are hyperbolic or not,¹⁸ they do represent another unconscious assumption,

14. The whole provision reads as follows:

A government lawyer who has discretionary power relative to litigation should refrain from instituting or continuing litigation that is obviously unfair. A government lawyer not having such discretionary power who believes there is lack of merit in a controversy submitted to him should so advise his superiors and recommend the avoidance of unfair litigation. A government lawyer in a civil action or administrative proceeding has the responsibility to seek justice and to develop a full and fair record, and he should not use his position or the economic power of the government to harass parties or to bring about unjust settlements or results.

EC 7-14.

15. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement.

16. As one noted commentator has put it:

The crucial division in the Code is between the Disciplinary Rules, the mandatory minimum standards of conduct, and the Ethical Considerations, the aspirational objectives of the profession. The fact is, however, that there is no such clear-cut division in the content and function of these two parts of the Code.

A. KAUFMAN, PROBLEMS IN PROFESSIONAL RESPONSIBILITY 31 (1976).

17. Rogers, *The Ethics of Advocacy*, 15 LAW Q. REV. 259, 269 (1899) (quoting Lord Brougham's speech in defense of Queen Caroline before the House of Lords in 1820). Lord Brougham continued his declamation as follows:

"To save that client by all expedient means—to protect that client at all hazards and costs to all others, and amongst others to himself—is the highest and most unquestioned of his duties; and he must not regard the alarm, the suffering, the torment, the destruction, which he may bring upon any other. Nay, separating even the duties of a patriot from those of an advocate, and casting *them*, if need be, to the wind, he must go on reckless of consequences, if his fate it should unhappily be, to involve his country in confusion for his client's protection."

Id.

18. Surely, they are often quoted as one measure of the lawyer's zeal for his client. Compare

which is at the heart of the Code of Professional Responsibility: that the world is composed of two groups, clients and nonclients; that clients are to be embraced and nonclients are to be kept at arm's length.¹⁹ This simplistic assumption coupled with the assumption that the client is a readily-identifiable-human-being leads to a perception of the lawyer's role as "the hired gun." Whatever quarrels one may have with my characterization of the duty of the usual advocate, it is clear that the duty has never been perceived to be to "justice" or to "fairness," except in an indirect or wholly derivative way.²⁰ Nevertheless, it is to those magnificent abstractions that the government lawyer is said to be directly obligated under the Code.

Not spelled out in the Code are the reasons for these higher duties to "justice" and to "fairness." Hints, however, are given. EC 7-13 notes that the prosecutor "represents the sovereign and therefore should use restraint in the discretionary exercise of governmental powers." There is also a reference to the need to be "fair to all" in matters affecting the "public interest."²¹ Obviously, the government lawyer has special responsibilities because he represents the "sovereign," which is another way of saying "the public interest," for in the United States, an axiom of our governmental structure is that the people are "sovereign."²²

Another reference in the Code to differences between the government lawyer and other lawyers is found in DR 9-101(B). That provision states: "A lawyer shall not accept private employment in a matter in which he had substantial responsibility while he was a public employee."²³ In *General Motors Corp. v. New York*,²⁴ the United States Court of Appeals for the Second Circuit held that a former federal government lawyer, retained by the City of New York to assist in an anti-trust action against GM, was disqualified from representing the City, even though the federal government had no objection to the representation. Normally in matters involving merely private litigants, the questions involved relate either to potential conflicts of interest or to

Curtis, *supra* note 7, at 4-5, with S. THURMAN, E. PHILLIPS & E. CHEATHAM, CASES AND MATERIALS ON THE LEGAL PROFESSION 280 (2d ed. 1970).

19. G. HAZARD, ETHICS IN THE PRACTICE OF LAW 45 (1978).

20. See Fuller & Randall, *Professional Responsibility: Report of the Joint Conference*, 44 A.B.A.J. 1159, 1161 (1958) (making classic case for proposition that if the lawyer does his partisan job properly, "justice" will be done).

21. EC 7-13, quoted in note 13 *supra*.

22. See R. DWORKIN, TAKING RIGHTS SERIOUSLY 18 (1977).

23. DR 9-101(B).

24. 501 F.2d 639 (2d Cir. 1974).

the possible disclosure of confidential information damaging to the former client. Moreover, the problem arises when a lawyer is involved in a matter on the opposite side from his former client. Courts have worked out a "substantially related" test to govern these cases. Under that test, the court determines whether the subject matter of the present case is substantially related to the matter the lawyer worked on for his former client. If so, the lawyer is disqualified.²⁵ This is normally a prophylactic rule, so the question of the actual misuse of confidential information is not made an issue.²⁶ Of course, the lawyer is always forbidden to use a confidence or secret of his client to the client's disadvantage.²⁷ This latter prohibition obviously extends beyond the termination of the lawyer's actual employment by the client.²⁸ But in *General Motors*, none of those factors was involved. The case did not involve side-switching; the federal government was not involved in the litigation. Moreover, the Department of Justice gave an opinion that the federal conflict of interest statute did not bar the lawyer's representation,²⁹ and therefore gave its tacit approval to the undertaking. Nevertheless, because the lawyer had worked on the same matter while in the employ of the federal government, canon 9's directive "to avoid even the appearance of professional impropriety" led the court to a fairly literal reading³⁰ of DR 9-101(B) in order to prohibit the representation. The policy justification was traced to a 1931 ABA Committee on Professional Ethics Opinion, which determined that such representation should be strictly prohibited, lest a government lawyer conduct public business in a way that tempts him to seek private employment either "to uphold or upset what he had done" as a government lawyer.³¹ This prophylactic rule, depending as it does on "appearances," marks another difference in the Code's handling of the ethical responsibilities of a government lawyer. Again, the standard is higher for the government lawyer; and again, although the ethical considerations do not explicitly refer to the reasons why this standard is higher, it is not

25. The best statement of the rule is to be found in *T.C. Theatre Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265, 268-69 (S.D.N.Y. 1953).

26. The classic case of the prophylactic application of the substantially related test is *Emle Indus., Inc. v. Patentex, Inc.*, 478 F.2d 562 (2d Cir. 1973). But see *City of Cleveland v. Cleveland Elec. Illuminating Co.*, 440 F. Supp. 193 (N.D. Ohio), *aff'd mem.*, 573 F.2d 1310 (6th Cir. 1977), *cert. denied*, 434 U.S. 856 (1978) (recognizing some flexibility in application of test).

27. DR 4-101(B)(2).

28. EC 4-6.

29. See 501 F.2d at 642-43.

30. The word "private," for example, simply meant "private practice" for remuneration, rather than the opposite of "public." See *id.* at 650.

31. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 37 (1931); see 501 F.2d at 649.

unreasonable to assume that the obligations to justice and to the public interest are operative in this situation, as they were in the cases under the cited provisions of canon 7.³² Indeed, EC 7-13 and EC 7-14 seem to reinforce DR 9-101(B).

Aside from DR 7-103 and DR 9-101, and their supporting ethical considerations, the only other reference to government lawyers in the Code of Professional Responsibility is under canon 8.³³ Under DR 8-101, a lawyer who "holds public office" is cautioned against using that position to obtain special advantages "for himself or for a client." Without belaboring the point, it seems obvious that these provisions remind the government lawyer once again of his special duties to justice, fairness, and the public interest.

There are no further references in the Code to the special obligations of the government lawyer.³⁴ This omission is indeed unfortunate, for the most serious problem for the government lawyer is, therefore, simply not addressed. For purposes of this article, it is sufficient to state the problem as one of "confidentiality." In order to understand the nature of the difficulties, however, the question of client-identity must be examined first. It is regarding this question of client-identity that the assumption that the client is a readily-identifiable-human-being shows its distorting influence.

II

I have argued elsewhere that the question "who is the client?" is the wrong question to ask in addressing the central problems of professional responsibility for the government lawyer.³⁵ The primary reason this is the wrong question is that the answer to it does not automatically answer other, separate questions of immense practical importance, not the least of which is the question of confidentiality. Under the present Code of Professional Responsibility, if the client can be identified as a single human being, the answers to the following practical questions are identical and can be automatically deduced from the mere identification of the client: (1) Who shall the lawyer take directions from in matters to be decided "by the client"?³⁶ (2) Whose "interests" is the

32. See notes 10-22 and accompanying text *supra*.

33. EC 8-8; DR 8-101.

34. A provision such as EC 7-11 seems simply to refer to the substantive provisions in EC 7-13 and EC 7-14, and therefore imposes no new obligations on the government lawyer.

35. Lawry, *Who Is the Client of the Federal Government Lawyer? An Analysis of the Wrong Question*, — Fed. B.J. — (1979).

36. See notes 42-45 and accompanying text *infra*.

lawyer trying to foster or protect?³⁷ (3) Whose "confidences" is the lawyer obliged to respect?³⁸ There is but one person, one person's interests and one person's confidences that need concern the lawyer.

For the government lawyer, however, the answer to each of these three questions is not necessarily the same. Even within a single question, the answer may differ from situation to situation. Under the Code, there is no indication that the draftsmen were even aware of this serious discrepancy. This unawareness has had the effect of making many provisions of the Code inapplicable to government lawyers. Among those provisions are all of canon 4, the confidentiality canon of the Code. I believe the problem was created by the mysterious workings of the client-as-readily-identifiable-human-being assumption. As Hazard has stated in reference to the client-identity question: "The legal profession's rules of ethics provide what is perhaps worse than no guidance. Instead of saying how or on what grounds the question of client identity is to be resolved, they assume it has somehow been resolved *ex ante*."³⁹ Because it is necessary to resolve the client-identity problem before provisions such as those relating to confidentiality can be intelligently applied, the literature is replete with articles arguing for one candidate or another.⁴⁰ At least four plausible candidates have emerged: (1) society or the public interest; (2) the government itself, viewed as a self-contained bureaucracy (the "state" as opposed to "society"); (3) the agency or department of the government, considered as a self-contained unit or entity; and (4) one or more officials of the agency or department, considered in their official capacities.⁴¹ Examination reveals, however, that no matter which candidate is selected as appropriate in the abstract, no consistent application of that choice is possible under the Code. To support this argument, it is necessary to examine the Code with respect to the three client-identity questions previously listed.

37. See notes 46-59 and accompanying text *infra*.

38. See notes 60-61 and accompanying text *infra*.

39. G. HAZARD, *supra* note 19, at 45 (1978).

40. See, e.g., *Risher Speaks on Legal Ethics, Calls for Decisions of "Conscience,"* FORUM, Jan. 1977, at 1 (newsletter of District of Columbia Chapter of Federal Bar Association); *Debate on Legal Ethics Continues*, FORUM, Apr. 1977, at 3.

41. The "public interest" is referred to in EC 7-13; the "government" is clearly the client for Hazard. G. HAZARD, *supra* note 19, at 54. "the agency and its officials" is the client for the Professional Ethics Committee of the Federal Bar Association. see notes 46-49 and accompanying text *infra*. For interesting philosophical distinctions among terms like Society, the State and the People, see J. MARITAIN, *MAN AND THE STATE* 1-27 (1951).

Question One: Who shall the lawyer take directions from in matters to be decided "by the client"?

This question involves the client as "directing authority." EC 7-7 states the traditional position regarding lawyer-client relations in the United States: "[With minor exceptions] the authority to make decisions is exclusively that of the client and, if made within the framework of the law, such decisions are binding on his lawyer." It is for the client to decide whether to take a settlement offer, what plea to enter in a criminal case, or whether an appeal should be taken.⁴² Who is the client as directing authority for the government lawyer? In the day-to-day course of business, the answer seems to be the lawyer's superior or superiors within the agency or department. First of all, obedience to superiors may be essential if the lawyer is to retain his job and protect his possibilities for advancement. But it is not clear the lawyer ought to accept his superior's decisions in the same way he clearly ought to accept the decisions of his private client. Under the Code, the government lawyer is said to have obligations to justice that are different from the usual advocate.⁴³ As a public prosecutor, the lawyer may be responsible for making decisions "for the client," who is referred to under EC 7-13 as the "sovereign."⁴⁴ Under EC 7-14 "[a] government lawyer who has discretionary power relative to litigation should refrain from instituting or continuing litigation that is obviously unfair." Moreover, even when he lacks discretionary power, a government lawyer "who believes there is lack of merit in a controversy submitted to him should so advise his superiors and recommend the avoidance of unfair litigation."⁴⁵ But the particularizations of EC 7-13 and 7-14 are not tied in any comprehensible way to the traditional statement in EC 7-7 concerning the right of the client to make decisions "binding" on the lawyer. Some consistency could be maintained if the special obligations contained in EC 7-13 and 7-14 were simply explained away as not applicable whenever the lawyer's government superior directs him to do something he considers unfair but that is legal. This is not only unacceptable because it negates the specialness of the government lawyer's obligations under the Code, but it is also contrary to the axiomatic norm of canon 5: "A Lawyer Should Exercise Independent Professional Judgment On Behalf Of A Client." EC 5-21 expounds on that

42. EC 7-7. The examples cited in the text are referred to as "typical."

43. EC 7-13, *quoted in* note 13 *supra*.

44. *Id.*

45. EC 7-14, *quoted in* note 14 *supra*.

axiom as follows: "The desires of a third person will seldom adversely affect a lawyer unless that person is in a position to exert strong economic, political, or social pressures upon the lawyer. . . . A lawyer subjected to outside pressures should make full disclosure to his client" It is therefore critical to know who is the government lawyer's client under EC 5-21, because only then will it be possible to determine who is a "third person." Clearly the assumption is working here again: there is an identifiable client, all others are potential "third persons," subjecting the lawyer to "outside pressures." But those pressures may be coming, not from the outside, but from within. When the drafters of the Code focused on these pressures, they recognized this problem, yet they failed to do anything about the anomaly. EC 5-18 is the relevant provision:

A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization.

This is the sole reference in the Code to entity representation, and not one of its examples is drawn from the world of government. Working with this provision by analogy, it would seem that to call the agency official the client for purposes of answering the first question is not clearly appropriate. Unlike the corporate lawyer, for whom it may frequently be easiest merely to follow the orders of his corporate superiors even though he knows they are not his client, the government lawyer has an obligation to justice or fairness because he represents the sovereign. Thus, for the government lawyer, the answer to the first question requires more than identification of a client. How much more may well depend on the answers to questions two and three.

Question Two: Whose interests is the lawyer trying to foster or protect?

In an important opinion of the Federal Bar Association's Ethics Committee, it was argued that the government lawyer is to serve "the public interest sought to be served by the governmental organization of which he is a part."⁴⁶ Proceeding upon this policy statement, the Committee went on to declare that the agency or department was the government lawyer's client.⁴⁷ The opinion was more complex than these

46. Professional Ethics Committee, Federal Bar Association, *Opinion 73-1*, 32 FED. B.J. 71, 72 (1973) [hereinafter cited as Professional Ethics Comm.].

47. *Id.*

statements indicate, and certainly more ambiguous in its practical analysis of the meaning of having the agency as a client.⁴⁸ Nevertheless, one government attorney who is deeply involved in teaching professional responsibility to government lawyers, stated that the opinion comes down "squarely on the side of the agency and its administrators as the clients of the government attorney."⁴⁹

At some level of generality, that position makes good sense. Working for the Environmental Protection Agency or the Department of Agriculture, the government lawyer concentrates his attention upon matters in a way that seems to foster or protect the interests of the environment or of our nation's farmers, which have been given over to each agency by legislation and administrative regulation. Each government lawyer, however, has an additional obligation to justice and fairness. If this devotion to the interest of the agency or department blinds the lawyer to the larger public interest to which each public official should be duty-bound, then the Federal Bar Association's position is too narrowly conceived.⁵⁰

The Code is clear on how a lawyer who is working for a private non-entity client is to handle cases in which other interests are involved. For example, if a wealthy man named Rex Lear wants to disinherit his longtime favorite daughter, Cordelia, because she will not profess her love for him in the same extravagant terms as her sisters, Goneril and Regan, surely it is the lawyer's obligation to draft the will as Lear wants it or else resign.⁵¹ There is no third option; the client's interests alone are the lawyer's responsibility, and the client himself is conclusively presumed to be the proper judge of his own best interests.⁵² Of course, the lawyer may try to change the client's mind when the act is foolish or unjust; the lawyer may even have an obligation to

48. See Lawry, *supra* note 35, at —.

49. W. Robie, *The Teaching of Professional Responsibility to Federal Government Attorneys: The Uneasy Perceptions* (unpublished paper delivered at National Conference on Teaching Professional Responsibility on Oct. 1, 1977). Robie is the Associate Director, Legal Education Institute, U.S. Civil Service Commission.

50. The government lawyer is a "public official." See the remarks of Dean Redlich in *ASS'N OF THE BAR OF THE CITY OF NEW YORK, PROFESSIONAL RESPONSIBILITY OF THE LAWYER: THE MURKY DIVIDE BETWEEN RIGHT AND WRONG* 94 (W. Galston ed. 1977) [hereinafter cited as *THE MURKY DIVIDE*].

51. Richard Wasserstrom believes it is necessary to resign in such a case on moral grounds. Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 *HUMAN RIGHTS* 1 (1975). Monroe Freedman argues that it is moral arrogance to substitute one's own opinion for that of the client's in cases like that of Rex Lear. Freedman, *Personal Responsibility in a Professional System*, 27 *CATH. U.L. REV.* 191 (1978). Obviously, neither author questions the main point made in the text: the lawyer either drafts the will as requested or he resigns. There is no third choice.

52. EC 7-8: "In the final analysis, however, the lawyer should always remember that the

try to change the mind of a client like Rex Lear.⁵³ If Lear is adamant, however, the lawyer drafts in accordance with the testator's wishes or the lawyer resigns.

There are some who believe the identical lawyer-client relationship exists between a government lawyer and the agency official who gives him directions. Richard H. Kuh, former District Attorney for New York County, has stated publicly his position on this matter: "If there is a problem, you are bound by the ethics of the official for whom you work, and if that is anathema to you, you hand in your resignation and write a book."⁵⁴ A longtime government lawyer, John Carlock, put it this way:

The theory seemed to be that the lawyer . . . had acquired some duty . . . to be the final arbiter of right and wrong. I cannot agree with this philosophy . . . I do not believe that the ritual of becoming a member of the bar invests a government lawyer with a power of life and death over the agency he serves. The agency head takes his own oath of office, and he is also subject to the inscrutable forces of public opinion. In carrying out his responsibility to decide policy, the agency head looks to his lawyer's counseling as one of his strongest supports; but the lawyer's counsel can never usurp the decision which must be made by the responsible head of the agency.⁵⁵

Carlock also believed the choice is between compliance and resignation.⁵⁶

But think of EC 5-18 once again. The lawyer's obligation is not to the individual but to the entity. I remain unconvinced that the decision of the official is the decision that conclusively determines the interests the government lawyer must foster or protect. Former canon 15 even contained an admonition against obeying the client's conscience rather than one's own.⁵⁷ How much more problematic is the case of obeying the conscience of one who is not clearly the client? I am also unconvinced that the particular "interest sought to be served by the governmental organization of which he is a part"⁵⁸ is the interest the

decision whether to forego legally available objectives or methods because of non-legal factors is ultimately for the client and not for himself."

53. *Id.* "In assisting his client to reach a proper decision, it is often desirable for a lawyer to point out those factors which may lead to a decision that is morally just as well as legally permissible."

54. THE MURKY DIVIDE, *supra* note 50, at 111.

55. Carlock, *The Lawyer in Government*, in LISTEN TO THE LEADERS IN LAW 255, 268-69 (1963).

56. *Id.*

57. ABA CANONS OF PROFESSIONAL ETHICS No. 15 provides in part: "He [the lawyer] must obey his own conscience and not that of his client."

58. Professional Ethics Comm., *supra* note 46, at 72.

government lawyer must foster and protect; nor is the interest even the interest of the "government."⁵⁹ The interest that the government lawyer labors for is the public interest. He is a public official, and the public must be the lawyer's client for purposes of answering the second question.

There is a sense, however, in which this answer is so abstract that it becomes merely rhetorical. Only when one encounters the implications of the answer to the third question dealing with confidentiality can the complexity of the client-identity problem be brought to a sufficiently concrete level to allow us to determine who is the government lawyer's client.

Question Three: Whose confidences is the government lawyer obliged to respect?

If a government lawyer has an ethical disagreement with his superior or if he believes the superior is not acting in the public interest, to whom may he turn for help or even for mere discussion of the problem? Under canon 4 of the Code, a lawyer may not reveal the confidences or secrets of his client.⁶⁰ Thus, the lawyer will first have to know who his client is before he can answer this question. Obviously, if the lawyer's client is an abstraction, an entity like a corporation or the sovereign itself, the practical problem is who speaks for the corporation or for the sovereign for purposes of canon 4. To answer that the head official of the agency is the client for a government attorney simply will not do. One example will immediately show why.

Under the express terms of canon 4, the lawyer may not disclose past illegalities unless his client consents.⁶¹ But what if the agency determines it is in the best interests of everyone not to disclose certain past illegalities perpetrated by agency officials. Is the government lawyer thus foreclosed from making that disclosure? Choosing the government as the client raises the specter of cover-ups of governmental wrongdoing. For what if the Attorney General concurs with the judgment of the agency head? Or the President himself? Or the entire matter seems to get lost in an avalanche of red tape or paperwork? Is the

59. Certainly not if the "government" is considered the "state," a part of the body politic, "a set of institutions combined into a topmost machine." See J. MARITAIN, *supra* note 41, at 12.

60. DR 4-101(B)(1).

61. There is an exception for future crimes, DR 4-101(C)(3), but not for past illegalities, except in the specialized case of fraud, and then only if the information is not privileged. DR 7-102(B)(1). For a discussion of the controversy surrounding DR 7-102(B)(1), see Lawry, *Lying, Confidentiality, and the Adversary System of Justice*, 1977 UTAH L. REV. 653.

government lawyer to be ethically bound by the Code of Professional Responsibility to perpetual silence? If one wants the answer to be "no" to this last question, then clearly the provisions of canon 4 must be substantially revised to fit the unique circumstances in which the government lawyer finds himself.

Of course, one could call the public interest the client and be realistically done with confidentiality altogether. If the public interest were the client, and the lawyer objected to a negotiating strategy or a trial tactic determined by his superior to be useful or necessary in securing a government contract or in winning a lawsuit, presumably nothing in canon 4 would prevent the lawyer from phoning the other side or writing a letter to the *Washington Post* while the matter was still pending. That alternative seems no more acceptable on its face than those that declared the agency or the government to be the client. The problem is that the conceptual apparatus of client and confidentiality simply does not work for the government lawyer in canon 4 terms.

III

For those who ponder the question of confidentiality and the government lawyer, canon 4 poses no serious problem, because although commentators still deal in the language of canon 4, it is effectively ignored.⁶² It should not be forgotten, however, that government lawyers remain bound by the Code operative in the jurisdiction where the lawyer has bar membership.⁶³ Ethically, canon 4 rules the lawyer in these matters. The resulting confusions cannot be ignored.

In Federal Bar Opinion 73-1, the Ethics Committee of the Federal Bar Association made a serious and thoughtful attempt to deal with the problem raised by the incongruities of canon 4 and the realities of the government lawyer's practice. Because of the tradition of treating confidentiality as a concept directly allied to client-identity, however, the Committee believed it necessary to answer the question "who is the client?" before addressing the central question of confidentiality. The answer was that the agency and its officers were the clients of the government lawyer. This answer meant that the relationship was a confidential one.⁶⁴ The Committee then discussed specific kinds of conduct by government officials, asking under what circumstances disclosures

62. See, e.g., *THE MURKY DIVIDE*, *supra* note 50, at 93-113; Professional Ethics Comm., *supra* note 46.

63. See W. Robie, *supra* note 49.

64. Professional Ethics Comm., *supra* note 46, at 72.

of that conduct might be made, and to whom.⁶⁵ Possible conduct by a government official was divided into four categories: corruption; clear illegalities with scienter; illegalities clear to the lawyer but subject to reasonable differences of opinion; and gross negligence.⁶⁶

These categories in no way correspond to the categories of conduct included in the exceptions to canon 4's prohibitions against disclosing confidences or secrets of the client.⁶⁷ Under the strict terms of canon 4, there would be no question that none of this past conduct could be disclosed without the consent of the client.⁶⁸ If the agency and its officials are the client, therefore, confidences or secrets could not be disclosed without permission of the head of the agency. Of course, the Committee did not analyze the question in those terms. It simply offered a series of prudential statements, which ultimately came to this: corruption and clear illegalities with scienter can always be disclosed, at least to the Attorney General;⁶⁹ possibly illegal and grossly negligent conduct ordinarily need not be disclosed beyond the personnel of the agency.⁷⁰ Of course, one suspects that ordinarily the first two classes of conduct will not have to be reported beyond the agency level either. These are obviously prudential maxims, however. More care should be given to the possibility that the lawyer may be wrong or "making a mountain out of a molehill" in the second two classes of cases. In the final analysis, however, the standard seems to be the same for all categories of conduct. The opinion states:

[D]isclosure beyond the confines of the agency or other law enforcing or disciplinary authorities of the Government, is warranted only in the case when the lawyer, as a reasonable and prudent man, conscious of his professional obligation of care, confidentiality and responsibility, concludes that these authorities have without good cause failed in the performance of their own obligation to take remedial

65. *Id.* at 73-74.

66. *Id.* at 71. "Corrupt" was defined as "venal conduct in violation of law and duty." "Illegal" conduct was divided into two categories. Category I was "[t]he willful or knowing disregard of or breach of law, other than of a corrupt character." Category II was "considered to be that about which the lawyer may hold a firm position as to its legality but which he nevertheless recognizes is in an area subject to reasonable differences of professional opinion as to its legality." "Grossly negligent" was said "not to lend itself to greater clarification than those words themselves indicate." *Id.* Presumably, "gross negligence" would be the "failure to exercise even slight care." See W. PROSSER & Y. SMITH, *CASES AND MATERIALS ON TORTS* 213 (3d ed. 1962).

67. Those categories are: (1) when clients consent; (2) when permitted under disciplinary rules or required by law or court order; (3) when necessary to prevent future crimes by clients; and (4) when necessary to collect a fee or defend oneself against accusations of wrongful conduct. DR 4-101(C).

68. See DR 4-101(B)(C).

69. Professional Ethics Comm., *supra* note 46, at 73.

70. *Id.* at 74.

measures required in the public interest.⁷¹

In analyzing similar questions involving the government lawyer and confidentiality, Dean Redlich arrived at conclusions almost identical to that of the Federal Bar Association's Ethics Committee in Opinion 73-1.⁷² Redlich gave the following hypothetical: Suppose you represent the City of New York, and you are questioning a police officer who allegedly drove negligently and injured a citizen. Although the city charter states that the city lawyer serves as lawyer for the police officer,⁷³ there is no doubt, says Redlich, that the lawyer has an obligation to disclose the information received from the officer to his superiors in order for those superiors to report it to the appropriate law enforcement people. Moreover, if the report is not made by the superiors to the appropriate law-enforcement people, the lawyer should make it himself, going outside the chain of command to see that it is done. And if nothing is done at the law-enforcement level? Redlich does not specifically answer this question, but he clearly indicates his belief that the lawyer as a public official has an "affirmative duty" to bring the relevant information concerning the wrongdoing "to the attention of someone who can do something about it."⁷⁴ Redlich does believe there is room for traditional ideas concerning confidentiality in cases in which the government lawyer, in giving legal advice to an official, explains the strengths and weaknesses of possible positions. But respecting wrongdoing on the part of an official, whether criminal or noncriminal,⁷⁵ Redlich sees "little if any room" for the operation of the traditional confidentiality concept.⁷⁶

Several important issues emerge from an examination of opinions like those of the FBA's Ethics Committee and Dean Redlich. The central question seems to be whether there should be bars of confidentiality placed between the lawyer and a potentially conflicting obligation to disclose information he has received as a government lawyer indicating that illegalities have occurred in the operations of the government. Depending on the answer to that question, a range of secondary issues emerge.

If one believes strongly in confidentiality, the issues are: What are the limits of confidentiality? Which officials are those with whom the

71. *Id.* at 74-75.

72. THE MURKY DIVIDE, *supra* note 50, at 95-97.

73. *Id.* at 95.

74. *Id.* at 97.

75. *Id.* at 96.

76. *Id.* at 97.

lawyer has a confidential relationship? If one believes there should be no final bar preventing the lawyer from ultimately disclosing such information, what rules or guidelines shall be established to deal with the common sense notion that everything that is said or done within the government should not become a matter of instantaneous public knowledge? This issue is obviously part of a larger public policy issue, most often connected with calls for "sunshine laws"⁷⁷ or with interpretations of the Freedom of Information Act.⁷⁸ The question being dealt with here, however, is narrower. It concerns the scope of ethical behavior on the part of lawyers working for the government. It is possible that government lawyers should not be bound by the Code of Professional Responsibility at all, that the nature of their positions as public officials places them outside (or perhaps above) the cares and concerns of ordinary lawyers. The choice to release government lawyers from the bonds of the Code should not be made, however, without prolonged and careful study.

In the interim, I would offer suggestions to amend the Code to deal with the problems of the government lawyer that have been discussed in this article. To do so, I must be candid about my policy choices. I believe the government lawyer must never be prevented from disclosing information he reasonably believes indicates that there have been illegal acts committed that touch the public business.⁷⁹ The lawyer should not be required to disclose such information; he should simply not be fettered by the Code of Responsibility if he chooses to disclose. On the other hand, I believe matters of policy, including issues of justice and fairness, are for the appropriate government officials; so long as no illegalities are involved, discussions and decisions made by officials are to be held in confidence by the lawyer. In order to defend these choices, the underlying policy justification for confidentiality must first be examined.

The modern policy justification for attorney-client confidentiality is the same as that which justifies the attorney-client privilege: the fear that there will be less freedom of communication from a client who is

77. See Note, *The Federal "Government in the Sunshine Act": A Public Access Compromise*, 29 U. FLA. L. REV. 881 (1977).

78. See Cox, *A Walk Through Section 552 of the Administrative Procedure Act: The Freedom of Information Act; the Privacy Act; and the Government in the Sunshine Act*, 46 U. CIN. L. REV. 969 (1977).

79. There seems to be widespread agreement on this point. See THE MURKY DIVIDE, *supra* note 50, at 97; Schnapper, *Legal Ethics and the Government Lawyer*, 32 REC. A.B.N.Y.C. 649, 649-50 (1977); Weinstein, *Some Ethical and Political Problems of a Government Attorney*, 18 ME. L. REV. 155, 160 (1966); Professional Ethics Comm., *supra* note 46. But see Carlock *supra* note 55.

not certain his lawyer will be bound to silence and who may therefore be reluctant to risk being harmed by a subsequent disclosure.⁸⁰ It has been argued that there is less justification for this policy in entity representation than in personal representation.⁸¹ The protection offered by the policy is less certain for the large corporations to which no clear rules apply because of the differences in the theories that protect one or another group of employees from having the lawyer-client privilege apply to them.⁸² Moreover, since the policy is clearly a utilitarian one, the more issues become public ones, the harder it is to justify allowing the privilege to prevent the full truth from being obtained.⁸³

Whether or not there is less justification for the lawyer-client privilege in entity representation, and thus less justification for the ethical norm of confidentiality, it may be assumed that a government official would be somewhat "chilled" by the knowledge that his disclosures may not always be confidential. These disclosures may, in fact, not only be made to superior officials, but also in some cases to law-enforcement officers or even to the public. Presumably, this chilling effect on the official increases the more the lawyer himself is freed from any strictures of confidentiality. The tradeoff, of course, is that an inflexible rule may permit the cover-up of serious, illegal conduct in matters of public concern. Although this is a policy question of some magnitude, my guess is that, in light of Watergate, there has to be an opportunity for lawyer disclosure. The opposite result would be unacceptable. Whistleblowers have had a notoriously difficult time holding their jobs after public disclosures of government corruption,⁸⁴ but they still wear the mantle of hero or patriot to most of the citizenry, even if the internal squeeze is often diametrically opposed to the public good.⁸⁵ In light of this phenomenon, it ought to be made clear that government lawyers cannot hide behind the ethics of the profession in maintaining

80. J. WIGMORE, EVIDENCE § 2291, at 543 (J. McNaughton rev. 1961); see H. DRINKER, *supra* note 1, at 132; M. FREEDMAN, *supra* note 10, at 4-5; Lawry, *supra* note 61, at 666-69.

81. Note, *The Attorney-Client Privilege: Fixed Rules, Balancing, and Constitutional Entitlement*, 91 HARV. L. REV. 464, 473-77 (1977).

82. *Id.* The Board of Directors may also determine after the fact that all lawyer-client confidences shall be waived for all corporate officers. A recent example of this is the decision by Gulf to allow one of its lawyers to testify before a grand jury concerning conversations the lawyer had with Gulf officials about bribes and pay-offs. See Wall St. J., Jan. 2, 1976, at 5, col. 2; Jan. 13, 1976, at 40, col. 1; Jan. 15, 1976, at 1, col. 6.

83. Note, *supra* note 81, at 477.

84. See WHISTLE BLOWING 39-179 (R. Nader, R. Petkas & K. Blackwell eds. 1972).

85. The most famous case is that of Ernest Fitzgerald. See *id.* at 39-54.

silence about known illegalities.⁸⁶

The problem, I take it, is basically with the word "should" that Dean Redlich uses in discussing his police officer case.⁸⁷ The Code of Professional Responsibility is already an intriguing document because of its unsteady mixture of "shoulds," "mays" and "musts."⁸⁸ The ethical considerations are supposed to contain "shoulds," that is, provisions that urge the lawyer to higher standards of behavior. The disciplinary rules are mandatory, but contain quite a few provisions that give lawyers the option of behaving in one way or another.⁸⁹ Canon 4 absolutely forbids disclosures of the client's confidences and secrets, but allows four exceptions.⁹⁰ Those exceptions, broadly worded, are all "mays." The lawyer may disclose a client's intent to commit a crime, but he does not have to.⁹¹ A lawyer may disclose a client's confidences when "required by law or court order," but he does not have to.⁹² The reason the Code is drafted in this way is that a strong presumption exists in favor of nondisclosure. There are cases, however, in which a competing policy would seem to be so strong that the lawyer should weigh everything in the balance before deciding whether to disclose. The Code should offer no artificial protection in cases that present the lawyer with this hard but important choice. Take the case of the future crime exception, for example. In Florida the language has been changed to make disclosure mandatory.⁹³ Under pain of disciplinary sanction, therefore, the Florida lawyer has to disclose "the intention of his client to commit a crime and the information necessary to prevent the crime."⁹⁴ But what if the crime is a relatively harmless misdemeanor, like putting a slug in a parking meter?⁹⁵ Or what if the lawyer

86. The point is simply that lawyers ought not to be able to justify failures to disclose illegalities because of alleged professional ethics. The justification must be personal, although it can obviously be made as a principled decision based on the individual's own conception of what is in the public interest.

87. *THE MURKY DIVIDE*, *supra* note 50, at 97; see text accompanying notes 72-76 *supra*.

88. Each of the axiomatic canons contain the word "should." Provisions such as DR 7-102 all contain the obligatory word "shall." Each exception to the obligatory "shall" language of DR 4-101(B) is a permissive "may." DR 4-101(C).

89. In addition to DR 4-101(C), see DR 2-110(C), which deals with permissive withdrawals, DR 5-105(C), which deals with conflicts of interest, and DR 7-101(B), which deals with limitations on zealotry.

90. See note 67 *supra*.

91. DR 4-101(C)(3).

92. DR 4-101(C)(2).

93. See A. KAUFMAN, *supra* note 16, at 115.

94. Florida Code of Professional Responsibility, DR 4-101(D)(2), FLA. STAT. ANN. rules (Harrison 1977).

95. The example is loosely drawn from A. KAUFMAN, *supra* note 16, at 113.

is not certain or wants to try to talk the client out of committing the deed? Surely there is good sense in allowing the lawyer some freedom ethically to try to do the best thing under all the circumstances. Just as surely, a statement should be included that the lawyer is not ethically constrained from trying to prevent a future serious harm.

My answer to the confidentiality question for the government lawyer is therefore (and not coincidentally) consistent with the present framework of the exceptions to confidentiality under canon 4. Thus, if the present format of the Code is maintained, I would suggest the following amendment to canon 4, which would become a new provision, DR 4-101(C)(5):

When employed as a government lawyer, any information that relates to illegal conduct by any public official in connection with any public matter or that relates to irregularities or illegalities reasonably believed to have occurred, to be occurring, or yet to occur in connection with any public matter, may be disclosed by the government lawyer to appropriate law-enforcement officials for action in the public interest.

If the appropriate law-enforcement officials fail to act upon the matter in a way reasonably consistent with the public interest, the government lawyer may disclose the information to the press or to whomever else he reasonably believes will be able to act upon the matter in a way that will be beneficial to the public interest.

In order to make this amendment work within the language of canon 4, the words "client" and "government lawyer" would have to be defined. New definitions, to be numbered (9) and (10) under the present Code structure, could read like this:

(9) A government lawyer is a lawyer who is employed by any government or any agency or department thereof, or by any public or quasi-public body, and who is acting in the capacity of a lawyer on behalf of his employer.

(10) The client for the federal government lawyer is the head of the agency or department or the head of the public or quasi-public body to which the lawyer is currently attached under appropriate governmental organizational practices or rules.

This definition of client would allow the government lawyer to disclose any information to the head of his department or agency on any matter. I do not think it useful to attempt to limit the range of confidential matters to officials lower than this, although there is no doubt that the same "chilling effect" is possible at all administrative levels. It seems to me that a rather free-wheeling discussion ought to be allowed

within the agency itself; and the top official ought to be the one to decide whether nonillegal matters go further. I realize this places the questions of fairness and justice in the hands of the head of the agency, not with the lawyer. I see no way a rule could be administered if these questions were also left to the lawyer. It is here that resignation becomes the only alternative. Since, however, these fundamental questions may not be aired under the present constraints, perhaps a rule indicating that the lawyer may disclose confidences concerning policy matters may be appropriate after he terminates his employment with the government. I may well support such a rule, but I would want to have a caveat to prevent such disclosure "while a matter is pending." There are questions of efficiency and responsibility here that seem to me to outweigh the need for immediate revelation of what are obviously matters upon which reasonable minds could differ.

IV

As an ABA blue-ribbon panel embarks upon the task of revising or rewriting the Code of Professional Responsibility, it must ask itself fundamental questions. One such question has been addressed in this article: How far shall the limits of confidentiality extend for the government lawyer? Before this question can be answered, a reappraisal of the concepts of client and of confidentiality must be undertaken. However much these two concepts are necessarily yoked together within the traditional context of a single private attorney and a single readily identifiable human client, the automatic application of these concepts to entity representation is unworkable. To attempt to make such an application is to be led into confusion by an unconscious assumption concerning the meaning of the word client. In representing an entity, the client may be one person or group for purposes of taking orders, another for determining the interests to be served, and still another for purposes of determining whose confidences ought to be respected. The problem is compounded for the government lawyer because, as a public official, he seems to have a special obligation to every citizen that is very different from that which an ordinary lawyer has in serving a private client.

My suggested changes in the Code solve only the most immediate problem, a problem brought about by prior conceptual confusions and unconscious assumptions; it is a problem that must be solved in light of the present, apparently widely shared policy agreement that no government lawyer should be deemed to be acting unethically if he chooses to

divulge information concerning illegalities in the performance of the public's business.

Presently, canon 4 is irrelevant to the government lawyer; consequently, amendments such as those suggested in this article are absolutely necessary, whether the Code is otherwise altered or not. My hope, however, is that my suggestions will spur others to engage in some fundamental rethinking of the conceptual framework of the Code. If this is done, I am convinced that detailed rules will be found necessary to govern the behaviors of different kinds of lawyers engaging in different kinds of practices for vastly different kinds of clients.

ADVOCACY AS MORAL DISCOURSE

THOMAS L. SHAFFER†

The freedom in which, in his distress, every man stands before God must not be disturbed. If, therefore, he is persuaded to overthrow the results of his reckoning without being first persuaded of the wrongness of his manner of reckoning; if his earnest determination be deprived of its objects without first being provided with its proper object; if he is made superficial and careless and muddleheaded where he had previously been strict and precise; then he is simply disturbed and led astray and hardened, and stumbling blocks and occasions of falling are piled up in his path. What he needs, however, is to be persuaded to break through, with the same earnestness and with the same determination to the place where—to the pure all things are pure.¹

Advocacy at its best is a form of reconciliation. It reconciles the advocate with those whose champion he proposes to be. It reconciles the advocate with his hearers. It reconciles the person whose cause is advocated with the persons who hear advocacy. It brings to community life a new sense of the interests of those the community neglects. It seeks to make things better. It is moral discourse.

After King David took Bathsheba, the wife of Uriah the Hittite, and arranged the murder of Uriah, the Lord God sent his prophet Nathan to the king. Nathan was sent to decry the injustice David had done to Uriah. "The sword shall never depart from your house," Nathan said to David. God, he said, would "raise up evil against you out of your own house; and . . . take your wives before your eyes, and give them to your neighbor Because by this deed you have utterly scorned the Lord, the child that is born to you shall die."² But before

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I am grateful for the advice and assistance of Professors Larry Churchill (Medicine, University of North Carolina), Donald S. Klinefelter (Philosophy, University of Tennessee at Chattanooga), Stanley Hauerwas (Theology, University of Notre Dame), and Robert E. Rodes, Jr. (Law, University of Notre Dame); and to Mr. Daniel M. Snow (Class of 1979, Notre Dame Law School). Portions of this article were given as a Roswell Gallagher Lecture to the American Society for Adolescent Medicine in December 1976.

1. K. BARTH, THE EPISTLE TO THE ROMANS 518 (6th ed. 1968).

2. 2 Samuel 12:10-14.

Nathan spoke in this judicial fashion, he engaged the conscience of David. He told him a story:

There were two men in a certain city the one rich and the other poor. The rich man had very many flocks and herds; but the poor man had nothing but one little ewe lamb, which he had bought. And he brought it up, and it grew up with him and with his children; it used to eat of his morsel, and drink from his cup, and lie in his bosom, and it was like a daughter to him.

Now there came a traveler to the rich man, and he was unwilling to take one of his own flock or herd to prepare for the wayfarer who had come to him, but he took the poor man's lamb and prepared it.³

When King David heard Nathan's story, he was angered at the injustice done by the rich man; David condemned the rich man, and then Nathan said to King David,

You are the man. . . . [God] annointed you king over Israel, and . . . delivered you out of the hand of Saul; and . . . gave you your master's house, and your master's wives into your bosom, and gave you the house of Israel and of Judah; and if this were too little . . . would add to you as much more. Why have you despised the word of the Lord, to do what is evil in his sight?⁴

The result of Nathan's advocacy was that David condemned himself. He prayed for relief from the Lord's judgment, and when the judgment came anyway, he acknowledged the justice of it. In the end, David was reconciled, "and," the scriptures say, "the Lord loved him." Bathsheba bore him a second son, Solomon, whose name means peace.⁵

The greatest advocates of our century—people such as Martin Luther King, Jr., or Mohandas Gandhi—have been Nathans. What made these advocates unique was their concern with goodness. They insisted on being concerned with the goodness even of the power brokers to whom they appealed. They based their advocacy on the goodness in those who were their clients. They appealed not to power but to conscience.⁶ Their advocacy tended to reconcile people rather than defeat them, as David was reconciled rather than defeated.

3. *Id.* 12:1-4.

4. *Id.* 12:7-9.

5. *Id.* 12:24.

6. My colleague, Professor Robert E. Rodes, Jr., raises a difficulty with this sentence: "Advocacy is addressed to people, not qualities, and if a person didn't have both of these [power and conscience], advocacy addressed to him would be fruitless. If the person of power had no conscience, you couldn't move him. If the person of conscience had not power, moving him wouldn't further your cause." I think, first, that it is possible to move decisionmakers by appeals to authority, to profit, and to values such as order, which are effective, or not, without regard to the conscience of the decisionmaker. That is what I mean by appeals to power. The mark of appeals to

This article will examine advocacy in two contexts. The first is advocacy to an institution, conducted in the name of justice or the welfare of the community; one might call this first category "public interest advocacy." The second is advocacy as a lawyer more normally practices it, before judges and on behalf of a particular client. In both cases, advocacy is different when pursued as moral discourse.

I. ADVOCACY TO AN INSTITUTION

A friend, an academic philosopher, related two experiences: First, he was employed on a grant to set up and, as they say, coordinate a series of community discussions of morals in banking, with particular emphasis on the distribution of capital by banks so that the poor get a share. Second, he spoke, by invitation, to a group of executives from a manufacturing company on the subject of moral reasoning in business. In the first case he noticed that the most coherent moral challenge to the banks came from an articulate, young, legal-services lawyer. The philosopher was impressed by the lawyer, but was dismayed to report that the lawyer's challenge had been ineffective. The bankers who heard the challenge were not influenced by it. In the second case, the philosopher had a similar experience himself; his coherent presentation of ethical insight was not heard.

The advocacy that failed here is common in America. It has occurred recently in the massive civil rights movement after 1954, in resistance to the Vietnam War, and in argument for better treatment of the poor, the mentally retarded and disturbed, prisoners, the handicapped, women, and even animals, mountains, rivers, and trees. Several preliminary observations about the nature of this advocacy are important.

It is almost always moral advocacy. The claims it makes are moral claims. If one were to state these claims in terms of principles, the principles would be moral. So, for example, the advocate argues from fairness, equality (an almost unquestioned moral value in America), the plight of the disadvantaged (no man is an island), the welfare of future generations, or that people are the stewards of nature. These claims are often legal as well as moral, but their force in law is consequential to their moral force; their legal character is consequent on the tendency of

conscience is that they seem interested—*really* interested—in the moral conversion of the decisionmaker. King, Gandhi and Nathan sought to lead, or push, the decisionmaker to "the place where—to the pure all things are pure." One result of living in that place is that one is reconciled to those he has, or might have, wronged.

public moral problems in America (slavery, abortion, racial discrimination, experimentation on live fetuses) to become legal problems.

It is not prophetic. Although this public interest advocacy probably cannot be said to be prophetic, it certainly *seems* prophetic: The advocate is making a moral claim; he is calling upon bankers to think of the poor, and upon business people to think of the employees and customers in their enterprises as their most important asset. In both cases, as is perhaps more typical of law-reform lawyers and philosophers than of lawyers in private practice, the advocates have decided not to use appeals to gain, even though other advocates of the same objectives use appeals to gain. Thus, while one could argue that concern for the poor is "good banking" in the profit-and-loss sense, or that sound human-relations programs in business produce profits, it is more characteristic of a prophet to disdain such argument and argue instead in terms of duty or goodness. A final aspect in which these advocates seem to be prophetic is that they do not mind being irritators. They have decided to take the risk of irritation. A characteristic of the prophet is that he puts himself at this risk.⁷

In all of these ways, the legal-services lawyer and the philosopher seem to be prophetic, but in other ways they are not, as, in contrast, Nathan, Gandhi, and Martin Luther King, Jr., were. They are not usually, for example, really *at personal risk*. Prophets (in the Old Testament mode anyway) are confrontive, uncivil, and direct. They seem less to persuade than to invoke the wrath of God (or deliver it). Nathan engaged the conscience of the king, a persuasive device, but he also said boldly, "You are the man." Gandhi told the English judges who sat on cases in which he was accused that they had only one choice—to send him to jail, or to come down from the bench and join him in his cause. King defied unjust law by breaking it and inviting the consequences. He sought to illustrate injustice by forcing his persecutors—the persecutors of his "clients," American black people—to stand up for unjust law. In all of these ways prophets seem to be not merely irritating but uncivil. Prophets also depend in some way on transcendent verification.⁸ Nathan spoke for God; King called on God.

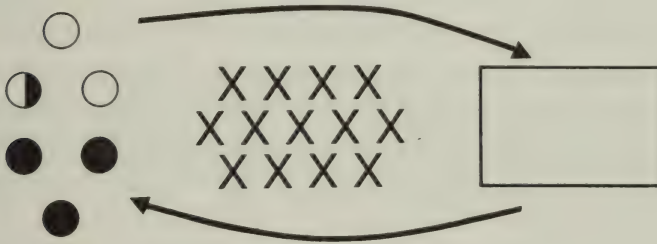
7. Vawter, *Introduction to Prophetic Literature*, in *THE JEROME BIBLICAL COMMENTARY* 227 (R. Brown, J. Fitzmyer & R. Murphy eds. 1968) ("[t]he fearless revelation of the moral will of Yahweh"). "It would be impossible to find a non-Israelite court prophet who would speak to his king as Nathan did to David . . ." *Id.* at 229.

8. Another way to say this is that the words of the prophet are greater than the prophet, but are still the words of the prophet himself. "The prophetic word lives a life of its own once it has emanated from the prophet, and the prophet is very much identified with the word that he has

Even democratic prophets—Gandhi is perhaps an example—call on the transcendent truth that is seen to have been vested in a people. Prophets speak in the name of this transcendence, more than in the name of reason. (It seems that either sort of discourse can be moral, that is, can be an appeal to conscience.) The legal-services lawyer and the philosopher called on reason more than on transcendence, and in this way, too, seem not to have been prophetic, even when they were advocates to conscience, seeking to persuade by addressing conscience.

It is ineffective. The legal-services lawyer and the philosopher were ineffective because they did not, as Nathan did, first engage conscience. They seem not to have known how conscience is addressed when decisionmakers act in groups—as they usually do when the issue is a public issue and the moral claims are made in the name of the community. Effective advocacy of the sort being attempted seems to require both a certain closeness to the decisionmaker (a shared vision perhaps⁹) and a certain detachment.¹⁰

My reaction to my friend's stories was an image:



uttered. . . . [The prophet] was personally involved in the word, . . . lived for it and was prepared to die for it." *Id.* at 237.

9. Father Vawter noticed that the prophets (1) insisted on the connection between religion and morality, although they were not usually religious leaders (*i.e.*, priests); (2) were connected with power (in Israel with the monarchy); but (3) were not political: "They inculcated a known morality or at least one that should have been known." *Id.* at 229-33. An advocate could argue to conscience and still not be a prophet in the other senses noted here. The difference may be personal risk. I doubt that an advocate can be a prophet unless he puts himself at risk.

10. The "classical" Old Testament prophets were almost deviant in their ecstatic or charismatic character, and at some times even affected distinctive dress. The Hebrew word for prophet means "one made to speak." The very fact of their speaking *for* someone (the Latin root for the word) also gives them detachment. In some cases Old Testament prophets were aliens—for example, the prophet Balaam in *Numbers* 22-24. Vawter, *supra* note 7, at 223-29.

The image represents a moral encounter that involves social justice. The arrows suggest apparent communication from the advocate (the square) to the decisionmakers (the circles) and back again, with the public (cross marks) turning its attention one way and then the other, as if watching a tennis game. This is the way a public moral debate looks when one reads about it in the newspapers: The lawyer accuses the banks of denying loans to the poor; the banks answer with economic and social data, or with folk wisdom. The philosopher tells the corporate managers about Aristotle and Aquinas and the moral shallowness of utilitarian argument. And they, if they reply at all, tell him about income statements and the barbarity of competition. Neither side appears to convince the other; neither appears to bring the other to pause or reflection. This is a debate; it does not look like moral discourse, because it does not seem possible that those who are accused will stop and say, "Gee, maybe you're right." They are, in Barth's phrase, being disturbed, led astray, and hardened.

It seems even less likely that the accuser will stop and say "Gee, maybe *I'm* mistaken." This is an important point. It seems necessary to moral discourse that the advocate himself be willing to be persuaded. When Thomas Aquinas talks about "fraternal correction,"¹¹ or Karl Barth about "conditional advice," each of them emphasizes this quality of openness in the advocate. Barth, for instance, says:

He who takes the risk of counseling must be prepared to be counseled in turn by his brother if there is need of it. Such mutual counseling in a concrete situation is an event. It is a part of the ethos which is realized ethics. . . . The ethos of the ethicist implies that he refrain from attempting too much and becoming thereby a lawmaker.¹²

This risk of being persuaded is corollary, perhaps, to the risk the prophet takes when he speaks boldly and risks his life.

The uncolored figures (little uncolored circles in the big circle, and the square on the right) are people who are or might join the advocate in being irritators; they might even become prophets.¹³ The difference between those in the circle and the square is the difference between being involved with power and being alienated from power. The

11. II ST. THOMAS AQUINAS, SUMMA THEOLOGICA 1333-41 (Fathers of the English Dominican Province trans. 1947).

12. K. BARTH, THE HUMANITY OF GOD 86-87 (1960). Barth speaks of discourse among theologians as one in which the theologian "waits for them [other theologians] and asks them to wait for him." *Id.* at 95.

13. The closeness of the prophet, note 9 *supra*, would be more likely for the circles than for the advocate.

square is alien here in two senses of the word. He is excluded by the group, and he chooses to be excluded. He is perhaps a deviant, in Kai Erikson's analysis of deviance—as Ann Hutchinson was in colonial Massachusetts, to use one of Erikson's cases;¹⁴ or as many of the early Abolitionists were to the American commercial enterprise that nurtured slavery.¹⁵ The suggestion of deviance is useful here because there seems to be a connection between being alienated from the decisionmakers and being ineffective in making moral claims on the decisionmakers. The square, which represents the legal-services lawyer in the banking story and the philosopher in the corporation story, is an irritator and a maker of moral claims, but he is ineffective—ineffective but visible, visible and sad. He is *ineffective* because the circle is impervious to his moral claim on it. He is *sad* in that preparation, good intention, and even rightness ought to have influence on those who wield power, but do not. Examples are sometimes tragic (Jesus before the resurrection, Socrates) and sometimes pathetic (the character representing William Jennings Bryan in "Inherit the Wind"). The result is personally sad, too, because the most admirable effort is often also the most intense effort; effort approaches tragedy as it becomes intense and nonetheless fails. Finally, he is *visible*, which is important because private failure seems more like frustration than like tragedy. This ineffectiveness is hard work, made visible, but come to naught.

The colored figures are the people who exercise power. They are among the circle of those who decide, but they are more influenced than influencing. In relatively organic groups (for example, some academic faculties), these are the elders. In boards of directors, they are the insiders. In business there may be only one such person, but usually, even when the corporation appears to be an autocracy, decisions are made in a group. In academic power groups, these exercisers of power are a minority of those who hold authority collectively. In some informal groups they are transient in membership but stable in their loyalty to a coherent tradition. While this group may sometimes be referred to as an "inner circle,"¹⁶ the existence of a core of power in such groups is more circumstantial than organizational: When it is a group rather than an individual, it is not chosen by anyone, not even itself; its authority is not usually planned. Its power is not formal, not

14. K. ERIKSON, *WAYWARD PURITANS* 71-107 (1966).

15. See generally S. MORRISON, *THE OXFORD HISTORY OF THE AMERICAN PEOPLE* 518-24 (1965).

16. See generally G. DOMHOFF, *THE BOHEMIAN GROVE AND OTHER RETREATS* xiii-xiv (1974); G. DOMHOFF, *THE HIGHER CIRCLES* (1971); G. DOMHOFF, *WHO RULES AMERICA* (1967).

negotiated. It does not show up on an organization chart. Such a group is not nearly as active as naive people suppose it to be; it often does not, for example, meet at all. It does not expressly decide, let alone articulate its decision, even when everybody knows what it will do. Its power, which is always real, is sensed by its own members most of all, and sensed to a lesser extent by social scientists and investigative reporters.

There is a distinction between the colored circles and the uncolored ones, but a person who is one can become the other. Change from one status to the other is probably the most common transience in groups that exercise power and is at the heart of their closed politics.¹⁷ What is distinctive about the uncolored circles is that they are eligible to be irritators and are therefore potential prophets. In business, they are the people who are chosen as targets by those who want to influence, change, or coerce corporate behavior. The Securities Exchange Commission thus makes demands regarded as drastic on "outside" corporate directors, or on independent auditors, or on lawyers retained to advise corporations. Professional groups, and those who think of themselves as articulators of the public interest, make similar demands on those members of the circle who think of themselves as professionals. Lawyers and accountants are clear examples.¹⁸ There are transitions toward professionalism by other members of the circle. An example is the public-relations professional, who is more clearly dominated by managers than lawyers and accountants are, but who is beginning to insist upon an extra-corporate professional (and moral) identity.¹⁹ In my image, the uncolored circles might be an accountant and a lawyer, and the half-colored circle a public-relations officer.

The uncolored circles are not only those on whom moral demands from outside are made; they are also those who are, ex-officio, eligible to make these moral demands on themselves, and, through themselves, on the organization. They are potential moral irritators who can be effective. They are more likely to be prophets than outsiders are.²⁰

17. An example in fiction is C. SNOW, *THE MASTERS* (1960).

18. See, e.g., Crock, *S.E.C. to Consider Rule Requiring Lawyers to Disclose Fraud by Corporate Clients*, Wall St. J., Aug. 3, 1978, at 5, col. 2.

19. See Montgomery, *In Public Relations, Ethical Conflicts Pose Continuing Problems*, Wall St. J., Aug. 1, 1978, at 1, col. 1.

20. That is, they are more likely than outsiders to (1) speak from a shared morality; (2) use arguments that are self-evidently valid; (3) identify personally with their moral claims (which lawyers, as lawyers, rarely do); (4) be close to power but not political; (5) speak for someone outside (or for God); and (6) by the very nature of things be at personal risk. See notes 8-10 *supra*.

That is why the outside world—the SEC, bar associations and investigative reporters—puts moral demands on them: Moral discourse is more likely to take place *within* the circle than between the circle and the square. Irritators from outside might better aim at initiating this moral discourse, and nourishing it with thought and concern, than at making moral demands on the organization as if the organization were monolithic. The organization is not monolithic.²¹ It in fact contains within itself the machinery for moral discourse and a way to conduct or discourage moral challenges that it has not yet considered. Moral arguments are heard there; more of them would be heard, and heard more carefully, if those who make moral demands on organizations understood the way moral discourse works in organizations. For examples:

The moral demand that women should have more status, pay, and responsibility is, in the political society, an argument from distributive justice. The moral discourse within the organization is more likely to be in terms of injuries to particular people and in terms of resources lost to the organization because of these injuries. At its most effective this argument turns on making partners of people who are otherwise dependents. The former demand, which is a demand from principle, makes decisionmakers defensive. It pulls the colored circles and the uncolored circles together in opposition to the demand. It tends to resolve itself, if at all, in coercion—usually in a lawsuit. The latter personal demand sounds and feels more like a wrong. If one thinks of himself as an advocate for women who should be advanced, he will do better to argue for *them* than for their *cause*. The uncolored circles tend to understand this; the square appears not to understand. An experienced trial lawyer would understand this point better than the young legal-services lawyer, or the philosopher, did.

The moral demand that corporate lawyers should call for independence from the chief executive officers who are their employers is a demand in principle.²² It turns on an idea about what corporate lawyers are; it turns, that is, on a role model. Proponents of that view might better ask what it is they want to accomplish (for example, more honesty in disclosure statements) and let the lawyer decide where best to initiate moral discourse. The lawyer, when he acts, might act more as business colleague, coreligionist, or friend than as lawyer.

21. For example, appellate courts may act as if they were monolithic, but notice evidence to the contrary, such as the common didactic advice to students in law school moot court programs to put one point in the brief for each of the judges who will hear the case.

22. See Palmieri, *Officers of the Board*, Wall St. J., Aug. 14, 1978, at 12, col. 3.

Moral claims about environmental pollution or exploitation of the poor seem least effective when irritators argue about the welfare of society and most effective when they make an argument, like the Prophet Nathan's, that says to the decisionmaker, "What are you doing?" It seems more effective to make the evil personal and personally discovered than to appeal to a general sense of responsibility. An accusation like Nathan's is less likely to be met with a utilitarian answer than is an appeal to civic responsibility.²³

All of this suggests that advocacy as moral discourse is not like advocacy as an alternative to warfare. It is different, tactically and dynamically. One should conduct it differently. Advocacy as moral discourse is more private (even intimate), quiet, and personal. It turns less on principles than on the story of the individual or the enterprise on whom moral claims are made.²⁴

II. LAWYERS' ADVOCACY: *SUPERINTENDENT OF BELCHERTOWN STATE SCHOOL V. SAIKEWICZ*²⁵

When, in April 1976, Joseph Saikewicz was found to have terminal leukemia, he was sixty-seven years old and had been for fifty-three years a resident in Massachusetts state institutions for the mentally retarded; he had an intelligence quotient of ten and a mental age of three years.²⁶ The prognosis was that he would soon die, but that chemotherapy might prolong his life by two months to a year. The chances of even that limited success were less than half, but most people who are able to make a choice for or against chemotherapy in this situation

23. Also, it seems important that Nathan had intimate access to the king; he was a member of the king's circle. See note 9 *supra*. It is important to emphasize that the moral irritator and the prophet are *at risk*. Professor Rodes suggested that my examples in text accompanying note 20 *supra* illustrate my claim better than other examples would. He mentioned Jesus' treatment of the Pharisees, William Lloyd Garrison, the Vietnam War protestors, and those bearing witness against the regime in Rhodesia. "There are," he said, "cases where you cannot be taken seriously unless you show that your claim transcends civility." I agree; the open (uncolored) circles in my image would be at greater personal risk in the cases Professor Rodes puts. They would also, probably, be less civil.

24. Other examples would be less intimate and less quiet, such as Gandhi and King, or the cases suggested in note 23 *supra*. Professor Stanley Hauerwas and I have urged that there is a difference, relevant on this point, between what the advocate does and what the "powers of this world," provoked to violence or fear, do in reaction to the advocate. Hauerwas & Shaffer, *Hope Meets Power: Thomas More and the King of England*, 61 SOUNDINGS 456 (1978) (also to be published as Hauerwas & Shaffer, *Hope in the Life of Thomas More*, NOTRE DAME LAW. (forthcoming)).

25. — Mass. —, 370 N.E.2d 417 (1977). For a contemporaneous discussion of the case, see N.Y. Times, July 14, 1976, at 26, col. 2; N.Y. Times, Dec. 1, 1977, at A18, col. 6.

26. — Mass. at —, 370 N.E.2d at 420.

choose chemotherapy.²⁷

The treatment is unpleasant but does not produce side effects that are unusual; Saikewicz had probably endured all of them. The usual side effects were nausea, vomiting, bladder irritation, numbness, and a tingling sensation in his hands and fingers.²⁸ Because the drugs are administered intravenously, and because Saikewicz would remember the side effects between treatments, the doctors expected resistance from him and planned to strap him to a hospital bed.²⁹ A doctor who knew him said, "When you approach him, he flails at you and there is no way of communicating with him, and he is quite strong; so he will have to be restrained and that increases the chance of pneumonia."³⁰ (Pneumonia was only a slight risk; the other risks were not unlike those parents choose every day when they offer up their children for hospital treatment.)

The alternative was, as the medical ethicists tend to put it, to "let him die." The superintendent of the Belchertown State School, where Saikewicz had lived since 1928, decided, probably from parental as well as medical premises (he is a physician), to give Saikewicz chemotherapy. He also decided, probably after talking to the school's lawyer, to seek a court order to that effect.³¹

The probate judge appointed a lawyer to represent Saikewicz. The lawyer at first assumed that this was a case for arguing "the right to treatment," an idea new in the law, as health care for the retarded is new in medicine. At this point, Saikewicz had the benefit of the aspirations of both professions. His advocates sought for him both prolonged life and the same care that moneyed, nonretarded people can obtain.

But Saikewicz's lawyer found that there were physicians in Belchertown who were against treating Saikewicz. Under their influence, the lawyer abandoned the "right to treatment" argument (even though the judge at first agreed with it) and argued instead that his client should be allowed to die.³² This lawyer said that Saikewicz would not be able to understand the discomfort and side effects of

27. *Id.* at —, 370 N.E.2d at 421.

28. *Id.* at —, 370 N.E.2d at 421.

29. *Id.* at —, 370 N.E.2d at 421 n.5.

30. N.Y. Times, July 14, 1976, at 26, col. 2.

31. — Mass. at —, 370 N.E.2d at 419.

32. See *id.* at —, 370 N.E.2d at 419. Although the case did not begin as a true adversary proceeding, it took on that characteristic when Saikewicz's lawyer began arguing against the right to treatment.

chemotherapy. Saikewicz himself, to the slight extent he could be consulted, would obviously resist treatment. This lawyer and the doctors on his side tried to decide what Saikewicz would want, and then tried to follow his "decision." That is also what the courts did. The probate judge and the justices of the Supreme Judicial Court of Massachusetts decided to let Saikewicz die without chemotherapy.³³ The local judge remarked that if he had been Saikewicz he would have preferred to die without treatment.

The advocacy that was used began with a consideration of what the client wanted—not what was best for him, but what he wanted.³⁴ And it proceeded in a moral discourse, between lawyer and physicians, that disregarded the professional ideals of prolonged life and the right to treatment. The opposing argument, made by the attorney general of Massachusetts, was that the interests of the state required chemotherapy for Saikewicz.

Saikewicz died in September 1976. It is not possible to know if his death was painless, but the physicians had predicted that it would be; the probate judge had ordered, in innocent but ironic evidence of the delusions of power, that Saikewicz be allowed to die "peacefully and comfortably."³⁵ The order of the Supreme Judicial Court had been entered in July,³⁶ but its opinion was delayed until the end of November, nearly three months after Saikewicz's death, so that the court could receive briefs on the issues and prepare an opinion that spoke to the difficult policy issues involved. Either because of the memory of what they thought in July, or out of judicial habit, their opinion is an example of moral discourse in appellate literature: The judges had become advocates.

The court's opinion is a remarkable and largely positive example of moral discourse. It is revealing in the way advocates and judges attempted to understand Saikewicz, and in their assertion of the minimum worth of a human being. It also reveals, curiously enough, a lot about the results of lawyer-dependent moral decisions by showing how our profession makes moral judgments for its clients when they are able to speak for themselves, as Saikewicz was not.

The main argument these lawyers, doctors, and judges used was Saikewicz himself; they refused to argue from an egalitarian category

33. *Id.* at —, 370 N.E.2d at 435.

34. *Id.* at —, 370 N.E.2d at 431.

35. N.Y. Times, Dec. 1, 1977, at A18, col. 6.

36. — Mass. at —, 370 N.E.2d at 419-20.

(all people are alike), which here would have led to chemotherapy since most people with Saikewicz's disease choose chemotherapy.³⁷ The court talked at some length about *In re Quinlan*,³⁸ and found that case less difficult because the New Jersey judges had had the benefit of the testimony of Miss Quinlan's father, who spoke from "many years of what was apparently a close and affectionate relationship with her."³⁹ The *Saikewicz* court struggled in an obviously sincere way to provide for itself a substitute for Mr. Quinlan's testimony without surrendering to "objective criteria." That meant that the court had to attempt to explicate reasons, personal to Saikewicz, against choosing a longer life. The court said that the value of life carried the same weight for Saikewicz as for any other person, but Saikewicz was different in that he would not understand the pain of treatment and could not therefore *choose to suffer*.⁴⁰ That bit of human nobility had been denied him.⁴¹ He could not cooperate with his doctors and therefore giving and receiving comfort was denied him. "He . . . would experience fear without the understanding from which other patients draw strength. The

37. It has been frequently argued elsewhere that cases of "substituted judgment" for the mentally incompetent, and other treatment of such people in the judicial process, has to proceed in terms of what "most people" would do. See, e.g., *Strunk v. Strunk*, 445 S.W.2d 145 (Ky. 1969). Elsewhere, the law seems unable to act when the person before it cannot behave as "most people" behave. See, e.g., *Jackson v. Indiana*, 406 U.S. 715 (1972); *State v. Lang*, 26 Ill. App. 3d 648, 325 N.E.2d 305 (1975), discussed in Myers, *The Strange Case of Daniel Lang*, 64 A.B.A.J. 1198 (1978); Annot., 38 A.L.R. Fed. 238 (1978).

38. 70 N.J. 10, 355 A.2d 647 (1976).

39. — Mass. at —, 370 N.E.2d at 430.

40. *Id.* at —, 370 N.E.2d at 430-31.

41. Self-determination seems necessary before one can talk of suffering as constructive. L. McCullough, *Pain, Suffering, and Euthanasia* (undated and unpublished) (Professor McCullough is in the Department of Philosophy at Texas A & M University).

[W]hat distinguishes suffering from pain is its personal quality. . . . [I]t may be that the function of medicine is to relieve painful suffering which makes it impossible for us to claim suffering as our own. . . . [W]e do not experience suffering until we know how to name it and we must be taught how to do that. . . . For suffering to be recognized, i.e. named, involves an interpretive context, then the very interpretation seems to carry a "point." The interpretation at least places the suffering in a narrative context

S. Hauerwas, *Reflections on Suffering, Death, and Medicine* (undated and unpublished) (Professor Hauerwas is in the Department of Theology at the University of Notre Dame). Karl Barth gives Christian expression to this idea:

In the Spirit, we are enabled to know the meaning of our life, as it is manifested in suffering. In the Spirit, suffering, endured and apprehended, can become our advance to the glory of God. This revelation of the secret, this apprehension of God in suffering, is God's action in us.

K. BARTH, *supra* note 1, at 301. Apprehension of God in suffering was apparently not available to Saikewicz, although a Christian must suppose that other means to apprehension of God were available to him, as the text on which Barth commented would imply: "[W]e suffer with him, that we may be also glorified together." *Romans* 8:17. The Massachusetts court's sense of wonder about Saikewicz's hidden personality is born of reflection on his suffering. Christian theology retains a similar sense of wonder about the hidden personality of Jesus.

inability to anticipate and prepare . . . leaves room only for confusion and disorientation."⁴²

The probate judge had premised his decision in part on "the quality of life possible for [Saikewicz] even if the treatment does bring about remission." The Supreme Judicial Court refused that reason "to the extent that this formulation equates the value of life with any measure of the quality of life," but it suggested that the judge may only have intended to take "special care . . . to respect the dignity and worth of Saikewicz's life precisely because of his vulnerable position."⁴³ People might very well be equal before the law, but they are never equal before one another, and the law had best take account of the fact that some of us are aggressive and many are victims. When advocacy argues from the person of its client, rather than from his interests or his cause, it can take account of his vulnerability.⁴⁴

The paternalistic arguments were arguments from professionalism—that is, prolongation of life and right to treatment. In many ways, the task of Saikewicz's lawyer was to defeat professionalism. In this case, professionalism, in serving power, argued from the interests of the state—notably for the preservation of (right to) life, and the ethical integrity of the medical profession. These arguments are of two rather different kinds. One was from equalitarian premises (apparently for Saikewicz's benefit but without regard for who he was); the other asserted the interests of third persons (Saikewicz should be kept alive in order that the interests of the medical profession would be served). The court decided, first, that the state cannot require a person to bear "the traumatic cost of [the] prolongation" of life unless he chooses to do so. "The value of life . . . is lessened not by a decision to refuse treatment, but by the failure to allow a competent human being the right of choice."⁴⁵ Second, the court noted that the prevailing ethical practice seems to recognize that the dying are more in need of comfort than treatment. It was not "necessary to deny a right of self-determination to a patient in order to recognize the interests of doctors." If it ever

42. — Mass. at —, 370 N.E.2d at 432.

43. *Id.* at —, 370 N.E.2d at 432.

44. My favorite example before the *Saikewicz* case was *Thompson v. Louisville*, 362 U.S. 199 (1960).

45. — Mass. at —, 370 N.E.2d at 425-26. The court extended to the incompetent whatever rights the competent have: "We recognize a general right in all persons to refuse medical treatment in appropriate circumstances. The recognition of that right must extend to the case of an incompetent, as well as a competent, patient because the value of human dignity extends to both." *Id.* at —, 370 N.E.2d at 427.

becomes necessary, the law will come down on the side of patients.⁴⁶

The *Saikewicz* case is an example of the reconciliation of the person whose cause is advocated with those who listen to advocacy. Reconciliation in this case was both easier and harder than it is in more usual cases: easier because the court's view of the "substituted judgment" doctrine required it to look as deeply as it could at the personality before it; and harder because this sort of care tempts judges to take the comfort of egalitarian solutions—to take a poll,⁴⁷ decide from conventional premises,⁴⁸ or let themselves be governed by professionalism.⁴⁹ The remarkable nature of the case is garnished by three facts that suggest how vulnerable conscience is in moral discourse: (1) *Saikewicz's* lawyer first argued for the right to treatment, then, upon reflection and after *moral* discourse with doctors, changed his mind and argued against the right to treatment. (2) The probate judge first decided to order treatment, then changed his mind. (3) The original order in the Supreme Judicial Court noted dissenting votes, but the final opinion as published is unanimous.

III. CONCLUSION: MORAL DISCOURSE AND THE COMMUNITY

Advocacy as moral discourse reconciles advocate to client, advocate to those who listen to advocacy, and those who hear advocacy to the client. It does this through exalting care over professionalism, through arguing to the consciences of those it addresses, and through arguing from the persons of those it advocates.⁵⁰ Advocacy radiates

46. *Id.* at —, 370 N.E.2d at 427. This reasoning was not applied by the Supreme Court of the United States to unborn children in the abortion cases because the Court did not extend the definition of "person" to the unborn child. *E.g.*, *Roe v. Wade*, 410 U.S. 113, 158 (1973).

The criticism that the *Saikewicz* decision arrogates power to judges, and takes it away from doctors, seems to me to miss the point that the Massachusetts court made—that patients should not be forced to suffer for the dignity of the medical profession. The point is the preservation of moral discourse in these "bioethical" cases. The Massachusetts court did that in *Saikewicz*; the Supreme Court of the United States refused to do it in *Roe v. Wade*. In both cases it was apparent that the medical profession had not preserved moral discourse. The court in *Saikewicz* took nothing away; it filled a vacuum. See MacIntyre, *Patients as Agents*, in 3 PHILOSOPHICAL MEDICAL ETHICS: ITS NATURE AND SIGNIFICANCE 197 (S. Spicker & H. Englehardt eds. 1977).

47. See O'Meara, *Natural Law and Everyday Law*, 5 NAT. L.F. 83 (1960); Note, *Naturalization—Good Moral Character as a Prerequisite*, 34 NOTRE DAME LAW. 375, 380 (1959). Both argue against measurement of public opinion as a solution to moral problems in the law; both essays refer to the "good moral character" cases in immigration law.

48. See, e.g., *Strunk v. Strunk*, 445 S.W.2d 145 (Ky. 1969).

49. The recent judicial immunity case is an example. See *Stump v. Sparkman*, 433 U.S. 349 (1978).

50. It perhaps, finally, serves the way people are. We seem to yearn for relationships, to overcome the alienation that professionalism only aggravates. See Kaplan, *Martin Buber and the Drama of Otherness: The Dynamics of Love, Art, and Faith*, 27 JUDAISM 196 (1978).

into the community, into consideration of social justice, because of four features that distinguish moral discourse from adversary discourse: (1) Moral discourse is interpersonal; (2) Moral discourse argues from the person of the client; (3) Moral discourse is addressed to the conscience of those who hear it; (4) Moral discourse, because it is a form of reconciliation, binds the community together.

Interpersonal. The *Saikewicz* case was unusual in method as well as in substance. It was different in medicine because many of the doctors involved argued against medical treatment. It was different for law because ordinary legal methodologies did not suit the case. The court pointed beyond ideas of health, or ideas of right, to Joseph Saikewicz himself. The judges decided he would be better off if our professions left him alone. What that poor man needed, as he ended more than half a century in a school for the retarded, was a friend as he died. The court could not explain his needs in terms either of health or of rights. It had to explain them in reference to Saikewicz himself.

Advocacy as moral discourse begins in the person of the client. The advocate has to cultivate an examination of conscience in which he asks himself where his advocacy does *not* begin. In the spirit of those little prayerbook questions we Catholics used to read before we went to confession, the first question is whether I have violated professional consensus. If what I am doing would be generally approved by my professional colleagues, it may be wrong—it may be more professional than personal. We lawyers have had some of our best moments when we were made uncomfortable by renegades such as William Kunstler and Michael Tigar. Maybe doctors have their best when they are challenged by renegades such as Thomas Szasz and the physicians at Belchertown who thought that the frail dignity of Joseph Saikewicz was more important than medical expertise. Advocacy as moral discourse seems to require humility, and the least likely humility is humility in a professional group.⁵¹

51. This is not to suggest that violation of professional consensus is some sort of *test* of the quality of moral discourse, but it is an important question, because people as part of professional groups seem more vulnerable to self-deception than people taken one at a time. The object, as Barth put it:

We stand in need, not of patience, but of the impatience of the prophets, not of well-mannered pleasantries, but of a grim assault, not of the historian's balanced judgement . . . but of a love of truth which hacks its way through the very backbone of the matter, and then dares to bring an accusation of unrighteousness against every upright man.

K. BARTH, *supra* note 1, at 395; see Hauerwas & Burrell, *Self-Deception and Autobiography: Reflections on Speer's Inside the Third Reich*, J. RELIGIOUS ETHICS, May 1974, at 2, reprinted in S. HAUERWAS, TRUTHFULNESS AND TRAGEDY 82 (1977).

Another test is whether we annoy our governors. When the community says that we are overstepping our bounds—that it is not a doctor's job to advocate, nor a lawyer's job to talk about what should be done for the sick—we are probably doing something right. We professionals have franchise and power, but we pay a price for it. The price is that we are expected to subordinate our personal sense of good to our expertise. The world needs to keep its experts in their place. Experts, as someone said, are supposed to be kept on tap, not on top. When we are on tap we are easy to predict. We annoy the world when we become unpredictable.

The person whose cause is advocated. Advocates of this sort find their mission in the unique personality of the client, and then hold that unique personality up as their strongest argument for change. They advocate a person more than a cause. Professionalism gets in the way here, too. It shows up in the legal profession in the nearly universal tendency to let adversary ethics, rather than the persons of clients, control advocacy.⁵² We lawyers use the adversary system to avoid moral discourse. We use it to hide all our great moral questions—the problem of the guilty client, the problem of assisting evil people to advance evil designs, and the ultimate problem of whether lawyers are of value either to their clients or to the community.⁵³ We are rarely caught in our evasion because we are attracted to it as a competitive game and we become good at the game. We come to think that it has validity. Stephen Wexler, a poverty lawyer, gives this example from a courtroom exchange several years ago:

[The case involved] a soldier who wanted to get out of the Army for religious reasons. His petition for *habeas corpus* was denied, and his attorney asked the court to prohibit the Army from transferring him to Vietnam pending the filing of an appeal. The Assistant United States Attorney on the case looked, for all the world, like an ordinary human being; yet, when the soldier's attorney asked for the stay of transfer orders . . . , the Assistant United States Attorney said "I'm afraid we'd have to oppose that."

No one even checked with the Army to see if it would cause a

52. E. CHEATHAM, *A LAWYER WHEN NEEDED* (1963), has this bias. I argue, in Hauerwas & Shaffer, *supra* note 24, and in Shaffer, *Justice in Everyday Life*, 22 RES GESTAE 394 (1978), that adversary ethics is the ethics of fear.

53. Shaffer, *Guilt Clients and Lunch with Tax Collectors*, 37 JURIST 89 (1977), is a clumsy beginning for discussion, and one I hope to rethink, on the guilty client problem and, through that problem, on the value of lawyers to clients. Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 HUMAN RIGHTS 1 (1975), is a persuasive analysis of the ethics of role in the legal profession. See also Shaffer, *Christian Theories of Professional Responsibility*, 48 S. CAL. L. REV. 721 (1975).

problem. The delay was opposed because within the lawyer's game it could be opposed. One little piece on the board was the U.S. Army, the other was the soldier; and the soldier's lawyer had just drawn a card which said: "ON HIS NEXT TURN THE OTHER PLAYER MAY MOVE YOUR PIECE TO VIETNAM."⁵⁴

One reason this sort of thing happens in the legal profession is the phenomenon of imputed competence. A client is not really allowed to think about the competence of his lawyer. He is to assume it. The professional is the one who knows how to move the pieces. This idea persists despite persuasive evidence that it is morally and fiscally untrue.⁵⁵

Our profession sometimes grows ashamed of its arrogance, but when it does it tends to turn clients into bureaucrats, as members of committees, instead of going back and looking at them as the reasons for the enterprise. In the legal world Mr. Wexler wrote about—poverty law—the profession decided that the solution to professional arrogance was to require the participation of the poor—not in the cases, but in the supervision of law offices. The clients were to become powers in the bureaucracy. Art Buchwald reports an interview he was inspired to give after the government and the legal profession made this decision. He finally located a man who would admit he was poor:

I asked him if he thought he would like to serve on a committee to see what could be done about poverty.

"Mister, if I had any ideas what to do about poverty, I wouldn't be poor."

"But there is a school of thought in Washington that poor people are the only ones who know the real problems of the poor, and they should be strongly involved in the program to formulate and implement antipoverty programs."

"I wouldn't serve on a board unless they paid me," he said.

"Oh, I'm sure they would pay you. If they agreed to pay you, what is the first thing you would do?"

"I'd move out of the neighborhood."

"But if you did that, you would lose contact with poor people and you would no longer be able to speak for them."

"Exactly. Poor people don't want to be spoken for. They just want to get the hell out of the neighborhood."⁵⁶

54. Wexler, *Practicing Law for Poor People*, 79 YALE L.J. 1049, 1060 (1970).

55. See generally D. ROSENTHAL, *LAWYER AND CLIENT: WHO'S IN CHARGE?* (1974). An interesting insight into this view of lawyers—and an interesting challenge to it—is a prescriptive list from the National Organization of Women for women seeking divorce lawyers. T. SHAFFER, *LEGAL INTERVIEWING AND COUNSELING* 142-43 (1976).

56. Buchwald, *A Penny for His Thoughts*, L.A. Times, Sept. 12, 1976, § V, at 2, col. 2.

Participation by the poor does not work. The reason it does not is that poverty in America is a moral question, as well as a political question. The advocacy that poor people need includes advocacy that requires the rest of us to look at poor persons, and to think about each of them, and to feel ashamed of ourselves for allowing such misery in the midst of plenty. Mr. Buchwald's point was that it will not do to tell the poor to take our money and go do something about themselves. What we should have learned was something about ourselves: We don't want to help the poor unless they fit our definitions.⁵⁷

The conscience of the hearer. The greatest example in Christian literature of advocacy to conscience is the story of Jesus and the woman taken in adultery: Some law professors brought the woman to Jesus, hoping to confound him and establish his disregard for the law. In the process they proposed to give the woman her just deserts. "Teacher," they said to Jesus, "this woman was caught in the very act of committing adultery. In our Law Moses gave a commandment that such a woman must be stoned to death. Now, what do you say?" St. John reports that Jesus wrote on the ground with his finger for a while, and then said, "Whichever one of you has committed no sin may throw the first stone at her." He returned to his writing and the law professors left. The woman stayed behind and held moral discourse with the Founder of Christianity.⁵⁸

The story illustrates how group consensus is an obstacle both to advocacy and to justice. There was no doubt about the rightness of a rule against adultery; Jesus, who was himself a teacher of Mosaic law, did not argue about that. He did not even argue about the sanction. But the rule and the sanction had hidden the reason for the enterprise, which was the goodness of people like that woman. Sometimes one has to bear witness against the rules in order to give purpose to the rules.

Dr. Larry Churchill, a medical ethicist, argues this way with reference to ethical rules in the medical profession: Professional ethics become accountable when they include within them "the capacity for self-restriction and self-criticism" on grounds other than those which currently undergird the profession.⁵⁹ "The absence of such a self-critical principle makes all questions raised by the public seem to be an

57. Moral advocacy for the poor has political implications, no doubt; what interests me at the moment is that political advocacy for the poor seems most feckless when it is not grounded in moral discourse.

58. *John* 8:3-11 (American Bible Society).

59. Churchill, *The Professionalization of Ethics: Some Implications for Accountability in Medicine*, 60 *SOUNDINGS* 40, 44-45 (1977).

attack and makes the healer's mantle an aegis from the variety of values held by his patients. It makes the physician an adversary of his patient instead of an advocate."⁶⁰ Dr. Churchill argues that doctors should develop a morality of self-accepted moral principles and move beyond a morality of conventional role conformity.⁶¹ "The transition . . . is blocked when there is confusion between group loyalty and the validity of the moral principles the group holds."⁶² The same argument applies concerning the adversary ethic in the law. The idea, as Churchill puts it, is "awareness of oneself as an autonomous agent, able to judge the morals of his group for himself."⁶³ Theories of health and theories of human rights would be enriched by that sort of moral enterprise. The enterprise becomes advocacy when we translate it into discourse outside the professional group. When advocacy begins, we will discover that we have become committed to something greater than our professions.

This process of seeking the conscience of the hearer involves a succession of steps. In the first step, the advocate points to rights, to principles that promise a benefit for his client. In the second step, he takes his client by the hand and makes personal claims on the decisionmaker, claims of conscience that do not rest on professionalism, but rest on the fact that we people are all in this thing together.⁶⁴ And then the dialogue, the discourse, becomes one in which people encounter people, and negotiate on the basis of what they need from one another and what they owe to one another.⁶⁵

60. *Id.* at 45.

61. *Id.* at 50.

62. *Id.*

63. *Id.*

64. The idea is so ordinary that it takes professionalism to obscure it. Galsworthy makes fun of the obscuring of interpersonal claims when he has Soames Forsyte say to his daughter Fleur, who is the defendant in a jury-tried libel case, "'The great thing is to keep still, and pay no attention to anything. They'll all be behind you, except the jury—and there's nothing in them really. If you look at them, don't smile!'" J. GALSWORTHY, *THE SILVER SPOON* 235 (1976).

65. This idea of law is developed in R. RODES, *THE LEGAL ENTERPRISE* (1976), and is suggested a bit in L. FULLER, *THE MORALITY OF LAW* (1964); Professor Fuller seemed, though, unable to get beyond applications to procedure. In *The Republic*, Plato had Thrasymachus assert that justice is the interest of the stronger. "[I]n all states there is the same principle of justice, which is the interest of the government; and as the government must be supposed to have power, the only reasonable conclusion is, that everywhere there is one principle of justice, which is the interest of the stronger." 1 *THE DIALOGUES OF PLATO* 603 (B. Jowett trans. 1892). Socrates insisted that the way to talk about justice is without reference to power. He insisted that this form of discourse will unite content (the issue of what justice is) and process (the concern of the discussers for one another): "[I]f we proceed in our enquiry as we lately did, by making admissions to one another, we shall unite the officer of judge and advocate in our own persons." *Id.* at 613; see notes 11 & 12 and accompanying text *supra*.

Moral discourse reconciles: it binds together the hearer, the advocated and the advocate. Three of the four heroes recommended here (Gandhi, King, and Nathan) were not lawyers, and the behavior of the fourth (Saikewicz's lawyer) was not traditional lawyer behavior. These facts suggest that there is a difference between advocacy as moral discourse and adversary discourse as it is traditionally described by the legal profession and as it is distilled into principles, aspirations, and inspiration in the American Bar Association's Code of Professional Responsibility.⁶⁶ It seems that there are differences, but that moral discourse and adversary discourse are not in all respects opposites. The differences are more tendencies than categories. For examples:

(1) Adversary discourse seems to involve ideals of dignity, image, influence, and survival in the professional group, the legal profession.⁶⁷ Moral discourse tends more to the development of a compassionate community. It tends to look beyond the group, and even beyond the state.⁶⁸ Both forms of discourse are advocacy; that is, each is addressed to decisionmakers and wielders of power. King, Nathan, and Gandhi addressed power as much as modern American lawyers do; Saikewicz's lawyer addressed power both as lawyers do and as King, Nathan, and Gandhi did. The difference seems to inhere in images—the roles, if you like—that members of professional groups have.

(2) Adversary discourse emphasizes uprightness, respectability, and moral independence in individual practitioners;⁶⁹ moral discourse emphasizes the moral claims of clients, and, more than is true in adversary discourse, identifies with the moral claims of clients. Moral discourse makes this identification with clients advertently, but it does not necessarily lose its identification with power groups as it does so: Saikewicz's lawyer did not surrender his status at the Bar; King steadily gained influence among powerful groups in America; Nathan, as prophet, both confronted the king and was a member of the king's

66. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement: "The Code is designed to be adopted by appropriate agencies . . . as an inspirational guide to the members of the profession . . ."

67. See note 69 *infra*.

68. The distinction between community (he says "nation") and state is elaborated in J. MARI-TAIN, *MAN AND THE STATE* 1-27 (1951).

69. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Canon 1 ("A Lawyer Should Assist In Maintaining The Integrity And Competence Of The Legal Profession"). This is related to the individual practitioner in EC 1-5: "A lawyer should maintain high standards of professional conduct . . . be temperate and dignified, . . . refrain from all illegal and morally reprehensible conduct." EC 3-1 and 3-2 and Canon 6 apply these ideals more specifically, in terms of competence and responsibility.

court.⁷⁰

(3) Adversary discourse seems to concentrate on loyalty to the client as its governing ethical principle; it exalts loyalty as a virtue.⁷¹ Moral discourse is based less on loyalty to the client than on the goodness of the client.⁷² King's leading the civil rights movement in prayer for its oppressors is an example of that—if one believes, as Dr. King did, that a believer seeks to rise to the aspirations of his prayers.

(4) Adversary discourse, in the Code's explication of loyalty as a virtue, comes to define its goal in terms of service to the government.⁷³ The reason for loyalty, as the Code explains it, is that loyalty will lead to more acceptable service to the judicial system (that is, to the government). Moral advocacy explains itself more in terms of service to the person; it radiates into the community because it is interpersonal, because it argues from the person of the client, because it is addressed to conscience, and because it seeks reconciliation rather than victory.⁷⁴ Its heroes are heroes of reconciliation, and that means that moral discourse does not serve power; it does not seek to justify itself in terms of power. This is a significant difference:

Justice is not the result of power. It is not the result of force. The idea that governments provide goodness—that power provides justice—is where tyranny begins.

We lawyers should be sober and watchful about the horrors of what people have done to one another in the name of the law. These horrors occur when people begin to believe that good can be achieved with power. The holocaust is one example. The crucifixion is another.

70. Charles Morgan is another, almost prophetic, example. See Powledge, *Something for a Lawyer to Do*, NEW YORKER, Oct. 25, 1969, at 63.

71. ABA CODE OF PROFESSIONAL RESPONSIBILITY, canon 5 ("A Lawyer Should Exercise Independent Professional Judgment On Behalf Of A Client"); EC 5-1 ("Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client"); canon 4 (confidentiality); and canon 7 (zealous representation).

72. See Shaffer, *supra* note 52.

73. Canon 2 ("A Lawyer Should Assist The Legal Profession In Fulfilling Its Duty To Make Legal Counsel Available"); EC 7-18 (lawyers should not communicate directly with clients of other lawyers because "the legal system . . . functions best when persons in need of legal advice or assistance are represented by their own counsel"); EC 8-1 (lawyers should propose and support legislation to improve the legal system).

74. Tillich has said:

[T]he ambiguities of competition . . . work continuously for inequality in the encounters of people in daily life, in the stratification of society, and in the political self-creation of life. The very attempt to apply the principle of equality, as contained unambiguously in the acknowledgement of the person as person, can have destructive consequences for the realization of justice.

3 P. TILLICH, SYSTEMATIC THEOLOGY 80-81 (1963).

The S.S. officer in "The Holocaust" did not set out to do evil. He did evil because he set out to do good with force and came to believe that force was the way to goodness. . . . It is probably a good thing for a nation to be saved, but it is corrupt and fatal to suppose that power can save a nation.⁷⁵

The Code tends to celebrate advocacy in the service of power. This is, to be sure, only a tendency. The Code is not palpably hostile to the sort of advocacy discussed in this article, but it neglects it. The tendency and the neglect might be illustrated with two texts from the Code. One, under canon 7 ("A Lawyer Should Represent A Client Zealously Within The Bounds Of The Law"), deals with the situation in which Joseph Saikewicz's lawyer found himself:

If the client is capable of understanding the matter in question or of contributing to the advancement of his interests, regardless of whether he is legally disqualified from performing certain acts, the lawyer should obtain from him all possible aid. If the disability of a client and the lack of a legal representative compel the lawyer to make decisions for his client, the lawyer should consider all circumstances then prevailing and act with care to safeguard and advance the interests of his client.⁷⁶

That aspiration, by turning more on the *interests* of the client than on the *person* of the client, tends toward argument for the right to treatment and against arguments that are based on a compassionate view of the client's situation. In *Saikewicz*, it was the proponents of chemotherapy who argued from Saikewicz's *interests*; the lawyer who argued for Saikewicz himself, and, ultimately, the judges in the case, grounded their decisions in something more human than interests.

A broader example is the final, summary ethical aspiration in the Code, under canon 9 ("A Lawyer Should Avoid Even The Appearance Of Professional Impropriety"). It illustrates that the Code's governing moral principles are loyalty to clients and service to power:

Every lawyer owes a solemn duty to uphold the integrity and honor of his profession; to encourage respect for the law and for the courts and judges thereof; to observe the Code of Professional Responsibility; to act as a member of a learned profession, one dedicated to public service; to cooperate with his brother lawyers in supporting the organized bar through the devoting of his time, efforts, and financial support as his professional standing and ability reasonably permit; to conduct himself so as to reflect credit on the legal profession and to inspire the confidence, respect, and trust of his clients and of the public; and to strive to avoid not only professional impropriety but also

75. Shaffer, *supra* note 52, at 397.

76. EC 7-12.

the appearance of impropriety.⁷⁷

By contrast, the examples used here as ideals share a tendency to reconciliation and disdain a tendency to support for power, professional honor,⁷⁸ and protected membership in a protected group. Martin Luther King's earliest public advocacy, in the bus boycott in Birmingham, started with his knowing the black people in the back of the bus. It proceeded with his holding up those people until the white citizens were ashamed of themselves.⁷⁹ It ended with people being brought back together—the advocates, the advocated, and the decisionmakers. That was Dr. King's usual procedure. In the heat and turmoil and cruelty of Selma, King gathered his followers together and prayed *for the police*. He talked to his followers about redemptive love—*for the police*.⁸⁰ His was like the procedure Gandhi used when he told the English judges that they had a choice—to uphold unjust laws and send Gandhi and his followers to prison, or to come down from their benches and join Gandhi in his witness against injustice. That is moral discourse—an interpersonal thing—a thing grounded in the person of the client, a plea to conscience, and a form of reconciliation.

77. EC 9-6. The reference to "brother lawyers" will strike many as uncommonly insensitive in a document drafted 10 years ago. That insensitivity and the Code's repeated celebration of the dignity of the profession are, I think, related.

78. See Lewis, *Christianity and Culture*, in *CHRISTIAN REFLECTIONS* 12 (W. Hooper ed. 1967).

79. Of course, the bus company lost money, but that was not the essence of the matter, even from a power-politics point of view.

80. One is tempted, in such a dramatic case, to see an opposition between love and justice; the opposition is useful in thinking about Dr. King's social witness. Dr. King might have admitted, though, that in the final analysis he sought a just order between the police and the people of Alabama:

[T]he basic ontological order is love, then justice; but in terms of the gradual achievement of order, the order may be [but was not in Selma] justice, then love.

... That love is indeed great—that considers whatever is here and now obstructive to one's neighbor and the community as no longer a right at all, demonstrative legal title and honest acquisition to the contrary notwithstanding. For love there is a clear distinction between abstract right and the actual need for that right.

... Before God, the duties of love are no less binding than the duties of justice. ... [T]he duties of love are measured by the progress of the person in good.

Haring, *Justice*, in 8 *NEW CATHOLIC ENCYCLOPEDIA* 68, 69-70 (1967).

COMMENT

ABA Code of Professional Responsibility: Void for Vagueness?

Professional groups have traditionally attempted to regulate their members through codes of conduct. Such codes share the general purposes of incorporating the highest ideals of the profession, of encouraging members to strive toward the attainment of those ideals, and of presenting to the public, which the professional group serves, the calling's most favorable image. Some codes of conduct may go no further than this, and thus are formulated in the broadest of terms, emphasizing public service, honesty, integrity, and other lofty traits as the guiding lights of members' professional careers. Other organized professions may seek to regulate their members' conduct in a more particularized fashion. Rather than merely exhorting colleagues to conduct themselves at all times as "honorable men," or some other equally vague precept, and leaving it to each individual to work out the "honorable" solution to each professional dilemma, these groups collectively attempt to make the hard choices in advance, setting them out in codes of conduct characterized by narrowly framed rules that all members are expected to obey. To ensure professional conformity and obedience, the rules must be backed by penalties, with exclusion from the profession typically the ultimate disciplinary sanction.

The Code of Professional Responsibility of the American Bar Association, adopted in 1969, functions as a particularized rather than an exhortative code of conduct. Though the ethical considerations of the Code are framed as general principles of conduct and are said to be only "aspirational" in character, the disciplinary rules (rules) are "mandatory," and prescribe the minimum level of conduct with which an attorney must comply in his relationships with clients, courts, and colleagues.¹ Failure to comply with any disciplinary rule may result in private or public reprimand, suspension, or disbarment of an attorney, with the particular punishment left to the discretion of the state bars and, ultimately, the courts.² Having seemingly made the choice to govern itself by specifically prescribing certain conduct for certain circumstances, the ABA nevertheless adopted various disciplinary rules that are written in such broad, general terms that they fail to prescribe any

1. ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement.

2. *See id.*

intelligible course of conduct.³ While such generally expressed professional *goals*, if they are so recognized, can serve a useful "aspirational" function, when such goals must serve as *rules* of conduct whose violation invokes severe disciplinary sanctions, they can become a trap for the unwary practitioner. If the legal profession were perfectly homogeneous, so that there was general agreement on the meaning of such terms as "moral turpitude" or "fitness to practice law," there would be no danger that some attorneys would be punished for conduct that they did not recognize as unprofessional at the time they engaged in it. It seems obvious, however, that no such consensus exists, for if it did there would be no need for a formal code of conduct.⁴

This Comment will discuss the problem of vagueness in the Code in light of its perceived purpose and function as a code of professional conduct. The void-for-vagueness doctrine, as developed by the United States Supreme Court in passing on the constitutionality of statutes, will supply the framework for analysis of the Code's disciplinary rules. Though focusing on DR 1-102 and DR 7-107 as examples of some of the problems created by vague regulatory language, discussion of the rules will necessarily be in general terms. The conclusion is that, though courts may be reluctant to interfere in the legal profession's self-regulation to the extent of actually declaring its rules void for vagueness, such a finding could be supported in terms of the vagueness doctrine. The bar could be more protective of attorneys' rights, while still regulating their conduct for the benefit of the public, by eliminating or clarifying the vaguely worded rules.

I. THE DEVELOPMENT OF THE VOID-FOR-VAGUENESS DOCTRINE IN THE UNITED STATES SUPREME COURT

The void-for-vagueness doctrine has had such broad, and often

3. DR 1-102(A), which serves as a catchall for any type of misconduct not covered elsewhere in the Code, is a prime example of an unintelligible rule of conduct. The rule in its entirety provides:

DR 1-102 Misconduct.

(A) A lawyer shall not:

- (1) Violate a Disciplinary Rule
- (2) Circumvent a Disciplinary Rule through actions of another
- (3) Engage in illegal conduct involving moral turpitude
- (4) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.
- (5) Engage in conduct that is prejudicial to the administration of justice
- (6) Engage in any other conduct that adversely reflects on his fitness to practice law.

4. See generally, J. ALERBACH, *UNEQUAL JUSTICE* 40-73 (1976).

unsystematic, application in the United States Supreme Court that even to refer to it as a "doctrine" may attribute to it more coherence than it possesses. The leading authority on vagueness cases in the United States Supreme Court has suggested that

the void-for-vagueness doctrine may be regarded less as a principle regulating the permissible relationship between written law and the potential offender than as a practical instrument mediating between . . . all of the organs of public coercion of a state and . . . the institution of federal protection of the individual's private interests.⁵

Though the application of the vagueness doctrine to invalidate a particular statute may frequently be inspired by practical concerns rather than compelled by an objective analytical test, several general principles may nevertheless be derived from the doctrine's development and use in the United States Supreme Court.

The vagueness doctrine encompasses two fundamental requirements of due process of law: that potential offenders receive adequate notice of prohibited conduct, and that enforcement of the laws be as uniform and nondiscriminatory as possible. Thus, in one of its earliest decisions voiding a criminal statute for vagueness,⁶ the United States Supreme Court pronounced: "[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law."⁷ Of later development than the adequate notice requirement,⁸ the second principle of the vagueness doctrine guards against the uncontrolled discretion allowed law enforcement personnel when a statute is so vague that it fails to provide adequate guidelines for enforcement.⁹ Without the indication of legislative intent supplied by a precisely worded statute, the

5. Amsterdam, *The Void-for-Vagueness Doctrine in the Supreme Court*, 109 U. PA. L. REV. 67, 81 (1960).

6. *Connally v. General Constr. Co.*, 269 U.S. 385 (1926).

7. *Id.* at 391. The statute at issue in *Connally* was an Oklahoma law requiring that persons employed by the state be paid not less than the "current rate . . . in the locality" where the work was to be performed. *Id.* at 388. The Supreme Court held that it contained a "double uncertainty" in that "current rate of wages" did not denote a definite sum, and "locality" did not precisely define the area. *Id.* at 393-95.

8. For other decisions relying on the notice element in voiding a statute for vagueness, see *Lanzetta v. New Jersey*, 306 U.S. 451 (1939); *Cline v. Frink Dairy Co.*, 274 U.S. 445 (1927); *United States v. Cohen Grocery Co.*, 255 U.S. 81 (1921).

9. The most notable recent decision stressing this factor is *Papachristou v. City of Jacksonville*, 405 U.S. 156 (1972), in which a vagrancy statute was voided for vagueness. The Supreme Court found that the failure of the statute to provide standards to guide enforcement left "unfettered discretion" in the hands of the police and provided a pretext for the arrest of any person whose lifestyle they disapproved. *Id.* at 168.

danger of arbitrary and discriminatory enforcement by police officers, courts and juries may be considered great enough to offend due process.¹⁰

A third problem with vague laws arises when the law "abut[s] upon sensitive areas of basic First Amendment freedoms,"¹¹ and thereby "operates to inhibit the exercise of [those] freedoms."¹² Because of the danger that a law regulating expression may infringe constitutionally protected rights, higher standards of specificity are exacted of such laws than of others that do not affect speech.¹³ Thus, the basic requirements of fair notice and adequate guidelines must be strictly observed in this area.¹⁴ In addition, standing requirements tend to be somewhat relaxed when regulations of expression are involved, and one whose conduct falls clearly within that prohibited by an otherwise vague statute may still raise the issue of vagueness when the first amendment freedoms of others are endangered.¹⁵

The vagueness doctrine has not been limited to criminal statutes in its application. Civil statutes, because they may provide a basis for the deprivation of liberty or property, are also subject to due process standards, including that of clarity.¹⁶ The "process" that is "due" in any

10. See, e.g., *Smith v. Goguen*, 415 U.S. 566, 575 (1974) (Massachusetts statute punishing "[w]hoever publicly mutilates, tramples upon, defaces or treats contemptuously the flag of the United States" void because its "standardless sweep allows policemen, prosecutors, and juries to pursue their personal predilections"); *Herndon v. Lowry*, 301 U.S. 242, 263 (1937) (statute, making "any attempt, by persuasion or otherwise, to induce others to join in any combined resistance to the lawful authority of the state" constitute an attempt to incite insurrection, impermissibly licenses jury to create own standard in each case).

11. *Baggett v. Bullitt*, 377 U.S. 360, 372 (1964).

12. *Cramp v. Board of Pub. Instruction*, 368 U.S. 278, 287 (1961).

13. *Hynes v. Mayor of Oradell*, 425 U.S. 610, 620 (1976); *Smith v. Goguen*, 415 U.S. 566, 573 (1974); *Interstate Circuit, Inc. v. City of Dallas*, 390 U.S. 676, 682 (1968).

14. See, e.g., *Hynes v. Mayor of Oradell*, 425 U.S. 610, 611, 621-22 (1976) (ordinance requiring that advance notice be given to local police by "[a]ny person desiring to canvass, solicit or call from house to house . . . for a recognized charitable cause . . . or . . . political campaign or cause" held void for vagueness); *Smith v. Goguen*, 415 U.S. 566, 575 (1974) (statute authorizing punishment by fine or imprisonment, or both, of anyone who "publicly mutilates, tramples upon, defaces or treats contemptuously the flag of the United States" invalidated as inherently vague); *Interstate Circuit, Inc. v. Dallas*, 390 U.S. 676 (1968) (classification scheme for motion pictures held unconstitutionally vague); *Winters v. New York*, 333 U.S. 507 (1948) (statute prohibiting printing and distribution of any publication principally made up of criminal news, police reports, or accounts of criminal deeds, or pictures, or stories of deeds of bloodshed, lust or crime, void on its face).

15. See, e.g., *Smith v. Goguen*, 415 U.S. 566, 577-78 (1974); *Gooding v. Wilson*, 405 U.S. 518, 520-21 (1972). In the first amendment freedoms of expression area the vagueness problem is virtually indistinguishable from the related constitutional doctrine of overbreadth, under which laws regulating expressive activity may be read to reach too far and prohibit expression protected by the first amendment, and are therefore constitutionally defective. See Note, *The First Amendment Overbreadth Doctrine*, 83 HARV. L. REV. 844, 871-75 (1970).

16. In one of the earliest decisions employing the vagueness doctrine, *A.B. Small Co. v.*

particular adjudication, however, depends upon the significance of the interest at stake and the corresponding severity of the potential sanction.¹⁷ Expressed in terms of the vagueness doctrine, the degree of clarity and specificity required of laws will increase as the potential sanctions for their violation increase in severity. Because the loss of personal liberty is generally considered to be more serious than a loss of property, the requirements of sufficient notice and adequate guidelines will be stricter upon statutes enforced by criminal rather than civil sanctions. The United States Supreme Court has recognized this principle,¹⁸ and, predictably, has invalidated far fewer civil than criminal statutes on vagueness grounds.¹⁹ The inevitable imprecision of written language must be tolerated to some extent, but highly valued interests such as personal liberty or liberty of expression may be limited only in the clearest possible terms.

Though it is virtually impossible to articulate a vagueness "test" for different types of statutes in absolute terms, a "sliding scale" may be visualized, upon which statutes regulating expression would be at the top in terms of precision required, followed by those enforced by criminal sanctions. Civil statutes enforced only by a taking of property would rest below criminal statutes on the scale. Property interests, however, may be of varying importance; the loss of a job or profession, for example, will generally be a more serious deprivation than the payment of a sum of money. Employment or professional regulations, therefore, should rest below criminal statutes, but above ordinary civil statutes, in the hierarchy of vagueness analysis. Because the Code fits within this general class of regulations, it will be helpful to examine the body of

American Sugar Ref. Co., 267 U.S. 233 (1925), the Food Control Act, whose limitation to a reasonable profit for necessities had previously been held unconstitutionally vague as the basis for a criminal prosecution in *United States v. Cohen Grocery Co.*, 255 U.S. 81 (1921), was also invalidated as a defense to a contract action for the price of sugar. Defendant's attempt to distinguish *Cohen* and other vagueness decisions as involving criminal penalties was rejected, the Supreme Court asserting, "It was not the criminal penalty that was held invalid, but the exaction of obedience to a rule or standard which was so vague and indefinite as really to be no rule or standard at all." 267 U.S. at 239. And in *Giaccio v. Pennsylvania*, 382 U.S. 399 (1966), the United States Supreme Court invalidated a state statute providing for the payment of court costs by an acquitted misdemeanor defendant upon the recommendation of the jury because the statute was so vague that it lacked any standards for its application. Whether labeled "penal" or "civil," the Court held, the statute gave the state a procedure for depriving an acquitted defendant of liberty and property, both of which were protected against state deprivation without due process standards. *Id.* at 402.

17. See, e.g., *Goss v. Lopez*, 419 U.S. 565 (1975); *Boddie v. Connecticut*, 401 U.S. 371 (1971); *Goldberg v. Kelly*, 397 U.S. 254 (1970).

18. See, e.g., *Barenblatt v. United States*, 360 U.S. 109, 137 (1959) (Black, J., dissenting); *Winters v. New York*, 333 U.S. 507, 515 (1948).

19. See *Amsterdam*, *supra* note 5, at 69 n.16.

law with respect to vagueness in such regulations in other contexts, in order to place the Code accurately on the sliding scale.

II. APPLICATION OF VOID-FOR-VAGUENESS DOCTRINE TO EMPLOYMENT AND PROFESSIONAL REGULATIONS

Because it is now generally recognized that public employees with a legitimate expectation of continued employment have a "property" and a "liberty" interest in their employment, and that such employment cannot be terminated by the state without the procedural safeguards required by due process of law,²⁰ it follows that an employee may not be dismissed or disciplined for infringement of an employment regulation that suffers from one or more of the defects of vagueness. In *Baggett v. Bullitt*,²¹ for example, teachers were required to take an oath that they would not engage in, or aid and abet, "subversive activity," because a Washington statute provided that no "subversive person" could be a state employee.²² The United States Supreme Court held that the statute and the oath were unconstitutionally vague; even construing the statute in its most favorable light, the Court ruled, it could not be said that the oath provided an ascertainable standard of conduct or did not require more than the state could command under the first and fourteenth amendments.²³ The *Baggett* decision, however, is a rare instance of actual invalidation of an employee regulation on vagueness grounds, and may be attributed to the fact that the oath clearly infringed rights protected by the first amendment.²⁴ In several decisions since *Baggett*, courts have been more lenient in their treatment of vague language in employment regulations.²⁵ Several factors seem to contribute to this attitude. First, it is recognized that when the conduct of a large and varied group of employees, such as civil servants, is sought to be regulated according to a common standard, it is simply not practical for the government to spell out all prohibited conduct in detail.²⁶ In *Meehan v. Macy*,²⁷ for example, the United States

20. See *Perry v. Sindermann*, 408 U.S. 593 (1972); *Board of Regents v. Roth*, 408 U.S. 564 (1972).

21. 377 U.S. 360 (1964).

22. *Id.* at 362.

23. *Id.* at 372.

24. See notes 11-15 and accompanying text *supra*. See also *Keyishian v. Board of Regents*, 385 U.S. 589, 603-04 (1967); *Spenser v. Randall*, 357 U.S. 513, 526 (1958).

25. See, e.g., *Arnett v. Kennedy*, 416 U.S. 134 (1974); *Civil Serv. Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548 (1973); *Meehan v. Macy*, 392 F.2d 822 (D.C. Cir. 1968).

26. *Arnett v. Kennedy*, 416 U.S. 134, 159 (1974); *Civil Serv. Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548, 578-79 (1973); *Waters v. Peterson*, 495 F.2d 91, 99 (D.C. Cir. 1973); *Meehan v. Macy*, 392 F.2d 822, 835 (D.C. Cir. 1968).

27. 392 F.2d 822 (D.C. Cir. 1968).

Court of Appeals for the District of Columbia Circuit commented, "[E]ven the most conscientious of codes that define prohibited conduct of employees includes 'catchall' clauses prohibiting employee 'misconduct,' 'immorality' or 'conduct unbecoming.'" ²⁸ Second, generalities in employment regulations are tolerated because they are not enforced by criminal sanctions. ²⁹ The gravity of the punishment involved (for example, reprimand, suspension or dismissal), however, may affect the degree of specificity required in the regulation. ³⁰ Third, vague rules may gain more definite content through "longstanding employment relationships," ³¹ previous warnings, ³² or a procedure by which an employee may get an authoritative ruling on the legality of a proposed course of conduct. ³³ These corrective factors ensure that notice is provided and thus may lend validity to an otherwise vague regulation.

Similarly, courts have found regulation of certain closely knit, specialized groups suitable for special consideration. In *Parker v. Levy*, ³⁴ the unique character of military society and the "longstanding customs and usages of the services" ³⁵ were held to give meaning to the "seemingly imprecise" standards of articles 133 and 134 of the Military Code of Justice. ³⁶ Reversing the United States Court of Appeals for the Third Circuit, which had held the two articles void for vagueness, ³⁷ the Supreme Court noted several factors that tended to narrow the articles' broad language. First, all military personnel were instructed on the

28. *Id.* at 835.

29. *See, e.g.*, *Arnett v. Kennedy*, 416 U.S. 134, 159 (1974); *Waters v. Peterson*, 495 F.2d 91, 100 (D.C. Cir. 1973).

30. *See, e.g.*, *Waters v. Peterson*, 495 F.2d 91, 100 (D.C. Cir. 1973). *But see* *Bence v. Breier*, 501 F.2d 1185, 1189 n.2 (7th Cir. 1974).

31. *Arnett v. Kennedy*, 416 U.S. 134, 160 (1974).

32. *See, e.g.*, *Goldwasser v. Brown*, 417 F.2d 1169, 1171 (D.C. Cir. 1969).

33. *See, e.g.*, *Civil Serv. Comm'n v. National Ass'n of Letter Carriers*, 413 U.S. 548 (1973).

34. 417 U.S. 733 (1974).

35. *Id.* at 746-47.

36. Article 133 of the Military Code, 10 U.S.C. § 933 (1976), prohibits "conduct unbecoming an officer and a gentleman," while article 134, *id.* § 934, condemns "all disorders and neglects to the prejudice of good order and discipline in the armed forces." Defendant, a physician and captain serving two years active duty, was convicted under both articles for making statements to recruits that United States involvement in Viet Nam was wrong, that black soldiers had no reason to go, and that the Special Forces were liars, thieves, and killers of peasants, women and children. He was sentenced to dismissal from the service, forfeiture of all pay and allowances, and three years hard labor. 417 U.S. at 738.

37. 478 F.2d 772 (3d Cir. 1973), *rev'd*, 417 U.S. 733 (1974). *See also* *Avrech v. Secretary of the Navy*, 477 F.2d 1237 (D.C. Cir. 1973), *rev'd*, 418 U.S. 676 (1974) (also holding the two articles of the Military Code void for vagueness). *Avrech* was reversed by the United States Supreme Court on the authority of its *Parker* decision.

contents of the Military Code, and a complete text would be made available on request to anyone on active duty.³⁸ Second, the United States Court of Military Appeals had construed both articles, supplying specific examples of the conduct covered, and partially narrowing their broad scope.³⁹ Though it recognized that vague areas remained in the articles' language despite these narrowing constructions, the Court held that the needed definiteness could be supplied by "less formalized custom and usage" of traditional military society.⁴⁰ Because of the special nature of the military, the Court further concluded that the proper standard of review for a vagueness challenge to the Military Code of Justice was the standard applied to criminal statutes regulating economic affairs, rather than that traditionally applied to statutes regulating first amendment freedoms of expression in civilian life.⁴¹ Because defendant should clearly have been on notice that his particular conduct was within the range of that prohibited by articles 133 and 134, the *Parker* Court reasoned, the articles could not be deemed vague as applied to him; furthermore, because the distinctive character of the military community required a different application of first amendment doctrines, defendant lacked standing to challenge the facial validity of the articles.⁴²

It is uncertain whether this watered-down vagueness analysis, tailored to the military context, might also be applied to regulations governing other professional groups that are less specialized than the military, but more cohesive than government civil servants. A police department regulation virtually identical to the Military Code's articles 133 and 134 was held unconstitutionally vague by the United States Court of Appeals for the Seventh Circuit in *Bence v. Breier*,⁴³ but the United States Supreme Court has not ruled on the question. The *Bence*

38. 417 U.S. at 751-52.

39. *Id.* at 752.

40. *Id.* at 754.

41. *Id.* at 756. It is apparently the overriding need for obedience and discipline in the military that justifies the reduced protection of constitutional rights among the armed forces. *Id.* at 758-59.

42. Though relying primarily on the military context of the regulation, the *Parker* Court also noted its reluctance in other contexts to strike down a statute on its face when there was a broad range of conduct to which it could be constitutionally applied. *Id.* at 757-61.

43. 501 F.2d 1185 (7th Cir. 1974), *cert. denied*, 419 U.S. 1121 (1975). Policemen Bence and Hanneman were reprimanded under rule 44, section 8 of the department's rules and regulations, which authorized dismissal or other punishment for "[c]onduct unbecoming a member and detrimental to the service." Their offense consisted of sending a letter to the city's chief labor negotiator, in which they made incorrect allegations on matters of departmental compensation. *Id.* at 1186-87.

court contrasted these departmental rules with the employee regulations in *Waters v. Peterson*⁴⁴ and *Arnett v. Kennedy*,⁴⁵ which were found not capable of being made more specific because they were intended to govern "myriad . . . federal employees performing widely disparate tasks."⁴⁶ The police regulations, in contrast, were formulated "to apply to an essentially homogeneous group of employees performing essentially similar job functions,"⁴⁷ and could thus be more precisely worded. Indeed, as the court of appeals noted, "the Chief of Police was able to specifically identify thirty other grounds for termination or punishment, each of which would presumably also be unbecoming conduct."⁴⁸ On the other hand, the court reasoned that a police department was not sufficiently specialized and differentiated from the rest of society to justify the lenient standard of specificity held applicable in the military context in *Parker*; nor was there a similar history and tradition to give the same content to the words "conduct unbecoming" that the *Parker* Court had gleaned from military tradition and precedent.⁴⁹ Concluding that the separate nature of military society had been the decisive factor in *Parker*, the *Bence* court distinguished *Parker* on that basis and, applying the traditionally strict test of vagueness in the area of rules affecting first amendment freedoms, invalidated the police department regulation.⁵⁰

In summary, though employment or professional regulations generally should rest below criminal statutes, but above ordinary civil statutes, in the hierarchy of vagueness analysis, the specificity required of them will also be affected by whether they curtail freedom of speech, whether they are enforced by reprimand or dismissal, and the breadth of the range of conduct that they must regulate. Additionally, the regulations of certain specialized professions may warrant different consideration because their members have taken on special responsibilities requiring curtailment of their liberty and because their differentiation from society and particular traditions lend a specificity to their rules

44. 495 F.2d 91 (D.C. Cir. 1973).

45. 416 U.S. 134 (1974).

46. *Id.* at 159; see text accompanying notes 26-28 *supra*.

47. 501 F.2d at 1190.

48. *Id.* at 1189.

49. *Id.* at 1191-92.

50. *Id.* at 1190-91. See also *Gasparinetti v. Kerr*, 568 F.2d 311 (3d Cir. 1977), *cert. denied*, 436 U.S. 903 (1978) (police regulations limiting discussion and criticism of superiors or other members held void on overbreadth grounds). But see *Kannisto v. City & County of San Francisco*, 541 F.2d 841 (9th Cir. 1976), *cert. denied*, 430 U.S. 931 (1977) (police regulation prohibiting "unofficerlike conduct" which "tends to subvert the good order, efficiency or discipline of the Department" not vague as applied to this petitioner).

that would not otherwise exist. While the Military Code of Justice has been placed within this category, police regulations generally have not. With these generalizations in mind, a consideration of the proper position of the lawyer's Code of Professional Responsibility in the hierarchy of the vagueness doctrine can be undertaken.

III. APPLICATION OF VOID-FOR-VAGUENESS DOCTRINE TO THE CODE OF PROFESSIONAL RESPONSIBILITY

With the recognition that public employees have a protectible property interest in their jobs, an attorney's license to practice may also be viewed as a type of "new property" of which she cannot be divested without due process of law.⁵¹ The Code of Professional Responsibility, because it governs an attorney's practice and can be the basis for suspension or removal of her license, must therefore be sufficiently specific in its terms to satisfy the due process requirements expressed in the vagueness doctrine. Additionally, because the sanctions authorized by the Code may be severe and stigmatizing, they may have the effect of depriving an attorney of her liberty to practice the profession she has chosen and qualified for.⁵² In order to evaluate the strength of these property and liberty interests and the extent of their potential deprivation under the Code, and thereby to determine the degree of specificity that should be required of the rules, further consideration must be given to the nature of attorney disciplinary proceedings, the possible sanctions imposed for violations of the rules, and the character of the legal profession itself.

State courts had generally assumed disciplinary proceedings to be civil actions⁵³ until two United States Supreme Court cases in the late 1960's forced a recognition that in at least some respects they are in the nature of criminal proceedings.⁵⁴ In *Spevack v. Klein*,⁵⁵ the Supreme

51. See *Willner v. Committee on Character*, 373 U.S. 96 (1963); *Schwartz v. Board of Bar Examiners*, 353 U.S. 232, 238-39 (1957); *Charlton v. FTC*, 543 F.2d 903, 906 (D.C. Cir. 1976); *In re Ming*, 469 F.2d 1352, 1355 (7th Cir. 1972). See generally Reich, *The New Property*, 73 YALE L.J. 733 (1964).

52. The Supreme Court has never precisely defined "liberty," but it has frequently stated that the term encompasses more than mere freedom from physical restraint. See, e.g., *Bolling v. Sharpe*, 347 U.S. 497, 499-500 (1954); *Meyer v. Nebraska*, 262 U.S. 390, 399 (1923). More recently, the Court indicated that a person's liberty is infringed when charges are made against him that "might seriously damage his standing and associations in his community," or endanger his "good name, reputation, honor, or integrity." *Board of Regents v. Roth*, 408 U.S. 564, 572-74 (1972).

53. See, e.g., *Sheiner v. Florida*, 82 So. 2d 657 (Fla. 1955); *In re Grae*, 282 N.Y. 428, 26 N.E.2d 963 (1940); *In re Rouss*, 221 N.Y. 81, 116 N.E. 782, cert. denied, 246 U.S. 661 (1917).

54. *In re Ruffalo*, 390 U.S. 544 (1968); *Spevack v. Klein*, 385 U.S. 511 (1967).

55. 385 U.S. 511 (1967).

Court overruled an earlier decision⁵⁶ and held that the fifth amendment privilege against self-incrimination is available to lawyers in disbarment proceedings. Justice Douglas, writing for the Court, reaffirmed the holding of *Malloy v. Hogan*⁵⁷ that the self-incrimination clause is applicable to the states through the fourteenth amendment, and added that "it extends its protection to lawyers as well as other individuals, and . . . it should not be watered down by imposing the dishonor of disbarment and the deprivation of a livelihood as a price for asserting it."⁵⁸ Referring to the language in *Malloy* that the state may not impose a penalty⁵⁹ for invocation of the privilege, Justice Douglas further stated that "penalty" did not refer only to fine or imprisonment, but to "any sanction which makes assertion of the Fifth Amendment privilege 'costly.'"⁶⁰ The threat of disbarment, with the consequent loss of professional standing and livelihood was not only costly, the *Spevak* Court concluded, but represented as powerful a form of compulsion as the use of the legal process against one accused of a crime.⁶¹

Though the Supreme Court never explicitly stated in *Spevak* that disbarment was a criminal penalty, given the language of the fifth amendment⁶² and the Court's broad definition of "penalty," the conclusion seemed inescapable. The next year, in considering another disbarment appeal in *In re Ruffalo*,⁶³ the Court hardly resolved the uncertainty when it dubbed disbarment trials "adversary proceedings of a quasi-criminal nature."⁶⁴ Attorney Ruffalo had been brought before the Ohio State Bar Association's Board of Commissioners on Grievances and Discipline on charges of soliciting clients in Federal Employers' Liability Act cases. He testified that he had hired an employee of the railroad company not to solicit clients among its employees, but only to investigate cases for him.⁶⁵ The Board subsequently added the hiring of one of the railroad's employees to investigate the

56. *Cohen v. Hurley*, 366 U.S. 117 (1961).

57. 378 U.S. 1 (1964).

58. 385 U.S. at 514.

59. 378 U.S. at 8.

60. 385 U.S. at 515.

61. *Id.* at 516.

62. "No person . . . shall be compelled in any criminal case to be a witness against himself . . ." U.S. CONST. amend. V.

63. 390 U.S. 544 (1968).

64. *Id.* at 551.

65. *Id.* at 546.

company as a charge against Ruffalo, and he was disbarred for that offense; the only evidence offered in the proceeding was the testimony of Ruffalo and of the investigator.⁶⁶ The Court reversed Ruffalo's federal disbarment on the ground that he had been denied procedural due process in that he had had no notice of the precise nature of the charges before the proceedings began.⁶⁷ In holding the attorney entitled to procedural due process, the *Ruffalo* Court noted, "[D]isbarment, designed to protect the public, is a punishment or penalty imposed on the lawyer."⁶⁸ Thus, though the Court never defined the term "quasi-criminal,"⁶⁹ it clearly indicated that it considered the gravity of the disbarment sanction sufficient to warrant substantial due process protection in any proceeding in which this sanction might be invoked.

State and lower federal courts have generally resisted the notion that disciplinary proceedings are actually criminal in nature.⁷⁰ This is a predictable reaction since to conclude otherwise would require significant changes in those proceedings, such as the assumption of a greater burden of proof by the state.⁷¹ Though recognizing that the potentially drastic consequences to an attorney require that disciplinary proceedings fully comply with due process,⁷² courts also point to the special function of such proceedings as inquiries into the fitness of officers of the court to continue to serve in a position of public trust.⁷³

66. *Id.* at 546-47. Ruffalo was disbarred from the federal district court in Ohio following his state disbarment. Only the federal disbarment was before the Court on this appeal.

67. *Id.* at 552.

68. *Id.* at 550 (citing *Spevack v. Klein*, 385 U.S. 511, 515 (1967); *Ex parte Garland*, 71 U.S. (4 Wall.) 333, 380 (1866)).

69. The *Ruffalo* Court cited *In re Gault*, 387 U.S. 1 (1967), as support for its use of the term "quasi-criminal." 390 U.S. at 551. *Gault* held that juvenile cases, though they had been traditionally labeled civil rather than criminal proceedings, must be vested with many of the procedural safeguards required in adult criminal trials, because the possible sanctions in juvenile court could be as severe as those in criminal court. 387 U.S. at 30, 49-50. In later decisions the Supreme Court held that the standard of proof required for juveniles accused of a crime is "beyond a reasonable doubt," *In re Winship*, 397 U.S. 358, 368 (1970), but also that there is no constitutional right to a jury trial in juvenile court, *McKeiver v. Pennsylvania*, 403 U.S. 528, 545 (1971).

70. See, e.g., *In re Ming*, 469 F.2d 1352, 1353 (7th Cir. 1972); *In re Echeles*, 430 F.2d 347, 349 (7th Cir. 1970); *Mildner v. Gulotta*, 405 F. Supp. 182, 191 (E.D.N.Y. 1975), *aff'd*, 425 U.S. 901 (1976); *Javits v. Stevens*, 382 F. Supp. 131, 138 (S.D.N.Y. 1974); *Black v. State Bar*, 7 Cal. 3d 676, 687, 499 P.2d 968, 974, 103 Cal. Rptr. 288, 294 (1972); *In re Schwarz*, 51 Ill. 2d 334, 282 N.E.2d 689, *cert. denied*, 409 U.S. 1047 (1972); *Howell v. State*, 559 S.W.2d 432, 435-36 (Tex. Ct. App. 1977).

71. The present standard of proof in disciplinary cases is "by a preponderance of the evidence." *Charlton v. FTC*, 543 F.2d 903, 906-07 (D.C. Cir. 1976); *Committee on Legal Ethics v. Graziani*, 200 S.E.2d 353, 355 (W. Va. 1973), *cert. denied*, 416 U.S. 995 (1974).

72. See, e.g., *In re Bithoney*, 487 F.2d 319, 323 (1st Cir. 1973); *Erdmann v. Stevens*, 458 F.2d 1205, 1210 (2d Cir. 1972); *Mildner v. Gulotta*, 405 F. Supp. 182, 192 (E.D.N.Y. 1975), *aff'd*, 425 U.S. 901 (1976).

73. See, e.g., *In re Echeles*, 430 F.2d 347 (7th Cir. 1970); *Mildner v. Gulotta*, 405 F. Supp.

The implication is that the public must be protected from unethical lawyers, and that this effort will be thwarted if erring attorneys must be afforded the full panoply of criminal due process. One answer to this argument is that the public in general will also receive the benefit of procedures tending to protect all members of the bar from removal without just cause; another, of course, is that the choice was made in the Constitution to afford the individual faced with severe penalties fair treatment even though such treatment involves a risk to society that a guilty person may go unpenalized.

Assuming for the moment that the vagueness standard for criminal statutes marks the upper limit of the Code's position on the scale, one may first consider the *minimum* level of specificity that the Code should be required to meet. Employment regulations in general, as concluded above, would be placed below criminal statutes but above other civil statutes in the hierarchy of vagueness analysis. The lawyers' Code, however, should arguably receive stricter scrutiny for vagueness than the regulations of other groups such as public employees. Attorneys must spend considerable time and money in order to become qualified for a license to practice law. The loss of that license⁷⁴ is usually, therefore, a greater deprivation of property than that suffered by a public employee who is dismissed from a job. The public employee, moreover, may often be able to find new employment that requires the same or similar skills, whereas the disbarred attorney is forbidden to use, anywhere in the state, the very skills he spent such time and energy acquiring. The former has lost a job, while the latter has been deprived of his profession.⁷⁵ Furthermore, disbarment, or even the lesser sanctions of suspension and reprimand, is by its nature a public penalty, marking the lawyer who suffers it a betrayer of public trust. The loss of reputation and public opprobrium attached to the punishment of attorneys for ethical violations thus infringe their liberty and bring these

182, 191-92 (E.D.N.Y. 1975); *State v. Turner*, 217 Kan. 574, 579, 538 P.2d 966, 973-74 (1975) (per curiam).

74. Disbarment is, of course, the stiffest of several possible penalties against an attorney once disciplinary action is begun by a state bar. Violations of the disciplinary rules may also result in suspension of an attorney's license to practice law for a specified period of time, or in issuance of a public or private reprimand or a letter of caution. Though the actual penalty imposed on an attorney would be a factor in a claim by that individual that the rule he was accused of violating was unconstitutionally vague, a vagueness standard for the Code must reflect that disbarment is a possible punishment for violation of any disciplinary rule.

75. Deprivation of a profession has been recognized to be a more serious property loss than that of a job. See, e.g., *Board of Regents v. Roth*, 408 U.S. 564, 573-74 (1972); *Cafeteria Workers Local 473 v. McElroy*, 367 U.S. 886, 895-96 (1961).

sanctions closer to the character of criminal penalties than are the range of sanctions normally invoked against public employees.

The foregoing analysis suggests that in terms of vagueness the Code should be closer to the top of the scale, approaching the specificity required of criminal statutes, than are other employment regulations. Rather than attempting to define the appropriate vagueness test by debating whether disciplinary proceedings should be labeled civil or criminal, it will be helpful to consider the substantive content of the term "quasi-criminal," used by the Supreme Court to characterize such proceedings. Given that the Court did not go so far as to conclude that all the due process safeguards of criminal trials should be transplanted to disciplinary proceedings, a reasonable interpretation of the term "quasi-criminal" in this context is that because the possible sanction against the individual attorney is grave, some of the procedural safeguards required in ordinary criminal trials will be carried over to disciplinary proceedings, unless the protection thereby gained for the individual is not significant enough to offset the resulting social and administrative costs. In terms of the vagueness test, the disciplinary rules of the Code should be required to meet the same strict standard of specificity as are criminal statutes if the added protection for the attorney and the accompanying benefit to the public outweigh the social cost resulting from the imposition of the strict standard.

Obviously, the clearly defined boundary between ethical and unethical conduct that would be required under a strict test for vagueness would be of great benefit to attorneys. Because most states hold that it is incumbent on every attorney to know the disciplinary rules,⁷⁶ and the punishment for imperfect knowledge is severe, an attorney needs to have clear notice of what conduct is forbidden. And to the extent that receiving clear notice of what conduct is deemed unethical will discourage attorneys from engaging in that conduct, the public will likewise receive a benefit from precise rules. On the other hand, requiring the Code to be precisely worded would not add the administrative costs that would be occasioned by the addition of other components of criminal proceedings, such as jury trials and the requirement of proof beyond a reasonable doubt, to disciplinary proceedings.

Furthermore, vaguely worded rules may invite state bar associations, or factions thereof, to weed out attorneys who are unorthodox or politically unpopular by current standards. This has happened in the

76. See, e.g., *State v. Alvey*, 215 Kan. 460, 524 P.2d 747 (1974).

past, during periods of political dissension and backlash in the bar, and vague requirements such as proof of "good moral character" or lack of "moral turpitude" have provided the vehicle.⁷⁷ The presence of standardless rules such as DR 1-102⁷⁸ leaves open the possibility that it could occur again.

Arbitrary enforcement can be expected if, for example, there is no consensus on what types of conduct are included in the phrase "prejudicial to the administration of justice." The lack of consensus on the meaning of this phrase is illustrated in *Howell v. State*,⁷⁹ in which an attorney, during a hearing on a previous citation for contempt, became a witness for himself on his motion for a continuance. He testified that he had asked four different attorneys to represent him on the charge, but each had refused because of the fear of possible prejudice in future appearances before the judge involved. When ordered to name the four attorneys, Howell refused, and his refusal became the basis for a charge of violating DR 1-102(A)(5), for which he was tried before a jury.⁸⁰ The jury found that Howell had refused to answer the question from the court, but also found that this refusal did not constitute conduct prejudicial to the administration of justice.⁸¹ The judge, however, set aside the jury's second finding and held that the issue was a question for the court;⁸² finding Howell guilty, the court ordered him publicly reprimanded. The Texas Court of Appeals affirmed.⁸³

This disagreement on the meaning of "prejudicial to the administration of justice" might have occurred because the jury were laymen and failed to appreciate the legal meaning of the term. The court, however, rejected a vagueness challenge to the rule by referring to its common everyday meaning.⁸⁴ Of course, there is no indication that the use of DR 1-102 in *Howell* was motivated by personal or political reasons,

77. See *Konigsberg v. State Bar*, 353 U.S. 252, 262-63 (1957); *Hallinan v. Committee of Bar Examiners*, 65 Cal. 2d 447, 421 P.2d 76, 55 Cal. Rptr. 228 (1966); Comment, *Controlling Lawyers by Bar Associations and Courts*, 5 HARV. C.R.-C.L.L. REV. 301, 312-14 (1970); Comment, *The Privilege Against Self-Incrimination in Bar Disciplinary Proceedings: Whatever Happened to Spevack*, 23 VILL. L.J. 127, 135-36 (1977).

78. Quoted in note 3 *supra*.

79. 559 S.W.2d 432 (Tex. Ct. App. 1977).

80. *Id.* at 433-34. Howell was also cited for contempt for his refusal to answer. The misconduct charge by the bar seems excessive because he was acting as a witness at the time, and because the information sought by the court was not really relevant to the merits of his case or essential for purposes of his motion for a continuance.

81. *Id.* at 434.

82. *Id.*

83. *Id.* at 438.

84. *Id.* at 435-36.

but it illustrates the ease with which the rule could be employed when such motivations exist.⁸⁵

In one sense, however, a Code consisting only of narrowly drawn rules might be considered contrary to the public interest. When prohibited conduct is narrowly defined, there is a greater likelihood that some types of conduct generally thought to be undesirable when engaged in by attorneys will not be covered by the proscription, either because such conduct was not foreseen by the drafters, or because it is very close to the forbidden zone, but not within it. Thus, it could be argued that like the regulations governing the conduct of civil servants,⁸⁶ the disciplinary rules cannot feasibly be made specific because they must govern too broad a range of conduct or too disparate a group.

Yet attorneys as a professional group would probably be considered more homogeneous than the civil servants in *Arnett v. Kennedy*⁸⁷ and *Waters v. Peterson*,⁸⁸ in which broadly worded regulations were upheld.⁸⁹ Additionally, the civil service regulations sought to set out a common standard of job protection for employees performing a variety of tasks,⁹⁰ while the Code's disciplinary rules are intended to define prohibited conduct and are backed by penal sanctions.⁹¹ Thus, though it would not be an easy task for the bar to draft a Code consisting only of precisely drawn rules, it does not appear that the task is made impossible by the nature of the legal profession. And in view of the serious penal sanctions backing the present rules, the bar can reasonably be expected to make the extra effort needed to achieve clarity. As the court noted of the police regulations in *Bence*, that the bar was able to formulate forty other, more specific grounds for reprimand or disbarment in the Code, each of which would also presumably constitute

85. Arbitrary use of DR 1-102 is facilitated by the practice of allowing bar associations to try an attorney on various factual charges of misconduct, and name the various disciplinary rules violated only upon pronouncement of a guilty verdict. See, e.g., *Javits v. Stevens*, 382 F. Supp. 131 (S.D.N.Y. 1974); *State v. Alvey*, 215 Kan. 460, 524 P.2d 747 (1974).

86. See notes 26-28 and accompanying text *supra*.

87. 416 U.S. 134 (1973).

88. 495 F.2d 91 (D.C. Cir. 1973).

89. Although attorneys do engage in widely varying forms of practice and frequently work in nonlegal areas, they all must attain a law degree and their work will generally involve legal problems. A civil servant, on the other hand, may be anyone from the lowest-level clerk to the highest bureaucrat, and the tasks involved range from typing to complex scientific analysis.

90. *Arnett v. Kennedy*, 416 U.S. at 159.

91. See notes 54-69 and accompanying text *supra*. In justifying their decisions, the courts in both *Arnett* and *Waters*, in contrast, noted that the civil service regulations were not intended to define criminal conduct. See 416 U.S. at 159; 495 F.2d at 99.

"conduct prejudicial to the administration of justice," indicates that the regulation of the legal profession could be effected through more precise language than that employed in DR 1-102.⁹²

Furthermore, the mere possibility of arbitrary and discriminatory enforcement has been an important factor in Supreme Court decisions voiding criminal statutes for vagueness,⁹³ indicating that the Court considers that danger important enough to outweigh the countervailing risk that precise statutes will not cover all undesirable conduct. Thus one may conclude that the disciplinary rules, in view of the purpose they are intended to serve, could fairly be held to the exacting standard of specificity required of criminal statutes, and that applying such a standard should not, on the whole, be contrary to the public interest.

One final consideration in this discussion of the degree of specificity to be required of the Code must be whether the legal profession is sufficiently cohesive and differentiated from society by its own history and traditions to give content to seemingly imprecise professional rules and to justify the application of a more lenient standard of vagueness to those rules, along the lines of that applied to the Military Code in *Parker v. Levy*. This rationale has been adopted by some courts,⁹⁴ but for several reasons it appears misplaced. Though new lawyers have generally received instruction on the ABA Code in law school in the same manner that new recruits in the military have been versed on the Military Code, it is less likely in the legal context than in the military context that the interpretations of those respective codes will be uniform. Moreover, the myriad interpretations of the ABA Code by various state and federal courts cannot carry the same authority as the years of narrowing construction of the Code of Military Justice by the

92. For examples of the use of DR 1-102 to cover a variety of sins, see *State v. Martindale*, 215 Kan. 667, 527 P.2d 703 (1974) (per curiam), in which an attorney was indefinitely suspended by the state bar for violations of DR 1-102(A)(5) and DR 7-109(B) (prohibiting the sequestration of witnesses). The Kansas Supreme Court found that attorney Martindale's actions (he met the state's witnesses by chance outside the courtroom and, not knowing they were under subpoena, advised them that they did not have to testify; he then neglected to inform the court that they had been there) did not amount to a violation of DR 7-109(B), but was conduct prejudicial to the administration of justice under DR 1-102(A)(5), because the attorney's silence misled the court. The court reduced the indefinite suspension to a public censure. *Id.* at 673, 527 P.2d at 707. And in *State Bar v. Semaan*, 508 S.W.2d 429 (Tex. Ct. App. 1974), the Texas Bar found an attorney had violated DR 1-102(A)(5) by criticizing a judge, on the basis of his qualifications, in a letter to a newspaper. The bar ordered a formal reprimand; the state court reversed it on appeal and found no violation of the Code. *Id.* at 434.

93. See notes 9 & 10 and accompanying text *supra*.

94. See, e.g., *In re Bithoney*, 486 F.2d 319, 324 (1st Cir. 1973); *In re Keiler*, 380 A.2d 119, 126 (D.C. Ct. App. 1977); *State v. Nelson*, 210 Kan. 637, 640, 504 P.2d 211, 214 (1972) (per curiam).

United States Court of Military Appeals. Although the word "prejudicial" in the phrase "conduct prejudicial"—the legal counterpart of the military's "conduct unbecoming"—may be found in frequent use throughout the legal system, this is hardly proof for the proposition that all attorneys would agree on the parameters of the conduct it defines, though they might well agree that certain types of conduct *would* fall within it.⁹⁵

Aside from such core areas of agreement, however, the legal profession is simply not as homogeneous, traditional and specialized in function as the military, whose unique character and customs were found to give a uniform content to the Military Code. Justice White has said that an attorney should not be disbarred under an unspecific standard if responsible attorneys would differ in appraising the propriety of the conduct cited.⁹⁶ Because responsible attorneys will inevitably differ over the meaning of "prejudice," "fitness" and "moral turpitude," and the conduct they define, the traditions of the legal profession are not adequate to fill in the gaps in those vague standards.⁹⁷

Moreover, the Military Code provision was upheld under a diluted standard of vagueness review because the special responsibilities of servicemen in defense of the country, and the overriding need for discipline and obedience in the armed forces justify more limited constitutional rights for servicemen than for civilians.⁹⁸ Though lawyers also have special responsibilities to the public as officers of the court, those responsibilities are not thought sufficient to warrant a similar restriction of their rights; the Supreme Court has on several occasions affirmed that lawyers must be guaranteed the same constitutional rights as laymen.⁹⁹

Thus there appears to be no compelling reason why the lawyers' Code should not be required to meet the same exacting standard of specificity as that required of criminal statutes. Because the scrutiny of statutory language must of necessity be tailored to the purpose and function of the particular statute under review, however, it appears to

95. See, e.g., *Office of Disciplinary Counsel v. Campbell*, 463 Pa. 472, 482, 345 A.2d 616, 621-22 (1975) (DR 1-102)(A)(5) and (6) are "arguably vague," but clearly applied to petitioner's conduct, which included fraudulent receipt of money for supposed illegal destruction of evidence).

96. *In re Ruffalo*, 390 U.S. at 555-56 (White, J., concurring).

97. On the growing stratification and lack of homogeneity in the legal profession in the twentieth century, see J. AUERBACH, *supra* note 4, at 40-73.

98. *Parker v. Levy*, 417 U.S. at 758-59.

99. See, e.g., *Spevack v. Klein*, 385 U.S. at 516. See also *Garrity v. New Jersey*, 385 U.S. 493, 500 (1966).

be impossible to define that standard in absolute terms (at least, the Supreme Court has not done so). But in practical terms, application of this standard means that if a statute or rule contains key words that are incapable of precise definition, this flaw will not be excused on grounds such as the mildness of its sanctions or the particular defendant's knowledge that his conduct came within the prohibition. Under such a standard, several of the disciplinary rules, notably DR 1-102, should be found unconstitutionally vague.¹⁰⁰ Furthermore, some of the rules clearly affect first amendment rights of lawyers, and thus should be subjected to the strictest standard of vagueness analysis.¹⁰¹ Some of the provisions of DR 7-107, concerning trial publicity, provide a good example of the vagueness problems in this area of the Code, because they directly control speech and have been a frequent source of litigation.

In the area of trial publicity, the first amendment rights of attorneys to comment on cases presently in litigation may conflict with the sixth amendment right of an accused to a fair trial before an impartial tribunal. Attorneys and courts generally agree that when this confrontation occurs, the attorney's right to speak must give way, to the extent necessary to protect the right to a fair trial.¹⁰² Rules restricting speech, however, must be drawn as narrowly as possible in order to avoid greater constraints on speech than the necessary minimum.¹⁰³

DR 7-107(D), (G) and (H) limit an attorney's extra-judicial remarks during the trial of a criminal, civil, or administrative matter by forbidding, at the minimum, comment on any matter "reasonably likely to interfere with a fair trial" of the action; DR 7-107(E) employs the same standard to limit comments prior to the imposition of sentence in a criminal proceeding.¹⁰⁴ The United States Court of Appeals

100. DR 1-102 presents the most obvious vagueness problem of all the rules because it appears intended to function as a catchall for any offenses not covered by the other rules. DR 7-107 will be discussed as the best example of vagueness in a rule affecting sensitive first amendment rights. Some of the more specific rules, however, also contain key words without precise meaning, making it difficult to determine exactly when the line between lawful and prohibited conduct is crossed. Examples of such rules include DR 5-105(A) ("A lawyer shall decline proffered employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be *adversely affected* by the acceptance of the proffered employment"); DR 6-101(A)(3) ("A lawyer shall not: . . . *Neglect* a legal matter entrusted to him"); DR 9-101(B) ("A lawyer shall not accept private employment in a matter in which he had *substantial responsibility* while he was a public employee.") (emphasis added).

101. See notes 13-15 and accompanying text *supra*.

102. See, e.g., *Chicago Council of Lawyers v. Bauer*, 522 F.2d 242, 248 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976); *Hirschkop v. Virginia State Bar*, 421 F. Supp. 1137, 1143 (E.D. Va. 1976), *aff'd in part, rev'd in part sub nom. Hirschkop v. Snead*, No. 76-2016 (4th Cir. Mar. 2, 1979).

103. *Procunier v. Martinez*, 416 U.S. 396, 413-14 (1974).

104. DR 7-107, Trial Publicity, provides in pertinent part:

for the Seventh Circuit held, in *Chicago Council of Lawyers v. Bauer*,¹⁰⁵ that this standard made the rule unconstitutionally vague and overbroad; the next year, a federal district court upheld the same rule against a vagueness challenge.¹⁰⁶ The *Bauer* court considered that, to pass constitutional muster, the rules must each incorporate the standard of "serious and imminent threat" of interference with a fair trial or the fair administration of justice as the threshold of prohibited speech.¹⁰⁷ This narrower formulation would put the lawyer on stricter notice of what was forbidden, and would eliminate the overbreadth

(D) During the selection of a jury or the trial of a criminal matter, a lawyer or law firm associated with the prosecution or defense of a criminal matter shall not make or participate in making an extra-judicial statement that a reasonable person would expect to be disseminated by means of public communication and that relates to the trial, parties, or issues in the trial or other matters that are reasonably likely to interfere with a fair trial, except that he may quote from or refer without comment to public records of the court in the case.

(E) After the completion of a trial or disposition without trial of a criminal matter and prior to the imposition of sentence, a lawyer or law firm associated with the prosecution or defense shall not make or participate in making an extra-judicial statement that a reasonable person would expect to be disseminated by public communication and that is reasonably likely to affect the imposition of sentence.

(G) A lawyer or law firm associated with a civil action shall not during its investigation or litigation make or participate in making an extra-judicial statement, other than a quotation from or reference to public records, that a reasonable person would expect to be disseminated by means of public communication and that relates to:

(5) Any other matter reasonably likely to interfere with a fair trial of the action.

(H) During the pendency of an administrative proceeding, a lawyer or law firm associated therewith shall not make or participate in making a statement, other than a quotation from or reference to public records, that a reasonable person would expect to be disseminated by means of public communication if it is made outside the official course of the proceeding and relates to:

(5) Any other matter reasonably likely to interfere with a fair hearing.

105. 522 F.2d 242 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976). See generally Note, *Professional Responsibility—Trial Publicity—Speech Restrictions Must Be Narrowly Drawn*, 54 TEX. L. REV. 1158 (1976).

106. *Hirschkop v. Virginia State Bar*, 421 F. Supp. 1137 (E.D. Va. 1976), *aff'd in part, rev'd in part sub nom. Hirschkop v. Snead*, No. 76-2016 (4th Cir. Mar. 2, 1979). The United States Court of Appeals for the Fourth Circuit upheld the specific limitations on statements by lawyers made prior to trial or disposition without trial of a criminal matter found in DR 7-107(B) and (C) with the "reasonable likelihood of interference with a fair trial" standard as an implied qualifier. *Hirschkop v. Snead*, No. 76-2016, slip op. at 9-27 (4th Cir. Mar. 2, 1979), *aff'g in part, rev'g in part Hirschkop v. Virginia State Bar*, 421 F. Supp. 1137 (E.D. Va. 1976). The court further held, however, that the restrictions on speech during bench trials, sentencing proceedings, disciplinary and juvenile proceedings, and civil trials were overbroad, and it concluded that the catchall proscription on statements about "other matters that are reasonably likely to interfere with a fair trial" in DR 7-107(D)-(H) was unconstitutionally vague. Slip op. at 33-37.

107. 522 F.2d at 249-50. See also *Markfield v. Association of the Bar*, 49 App. Div. 2d 516, 370 N.Y.S.2d 82 (1975) (incorporating "clear and present danger" standard into provisions of DR 7-107).

problem, though the rule would still suffer from vagueness without specific rules as examples of speech that would presumptively pose a "serious and imminent threat" to a fair trial or (in the pretrial stages covered in DR 7-107(A), (B) and (C)) the fair administration of justice.¹⁰⁸ Additionally, the *Bauer* court held that some of the specific provisions of DR 7-107 must be articulated more narrowly than at present.¹⁰⁹

In contrast, the United States District Court for the Eastern District of Virginia concluded in *Hirschkop v. Virginia State Bar*¹¹⁰ that the "reasonably likely" standard offered the least drastic, effective method of protecting an accused's right to a fair trial against prejudicial publicity.¹¹¹ The standard provided adequate notice, the court reasoned, when considered in the context of its applicability only to trial lawyers, who should know what statements would be reasonably likely to interfere with a fair trial.¹¹² Accepting defendant's assurance that the specific restrictions in DR 7-107(A), (B), (G) and (H) were to be read as incorporating the "reasonably likely" standard, the district court held that the rules were constitutional.¹¹³

The *Bauer* court's reasoning with regard to the language of DR 7-107 appears to reflect more accurately the concerns expressed in the doctrine of vagueness than that of the *Hirschkop* court. The *Bauer* court applied an exacting standard of specificity to the rule, which is appropriate in light of its encroachment on first amendment rights and the serious sanctions for its violation. The *Hirschkop* court, on the other hand, evaluated the rule in terms of the standard in *Civil Service Commission v. National Association of Letter Carriers*,¹¹⁴ in which the United States Supreme Court upheld civil service regulations that were "set out in terms that the ordinary person exercising ordinary common sense can sufficiently understand and comply with, without sacrifice to the public interest."¹¹⁵ This standard, however, is less exacting than

108. 522 F.2d at 250.

109. The court invalidated any presumption of a serious and imminent threat arising from a defense attorney's extra-judicial statements during the investigative stages of a criminal trial, *id.* at 253, held that the catchall "or other matters" language of 7-107(D) must be eliminated, *id.* at 256, and, finally, rejected any presumption of a serious and imminent threat arising from extra-judicial statements made during a civil proceeding, *id.* at 258.

110. 421 F. Supp. 1137 (E.D. Va. 1976), *aff'd in part, rev'd in part sub nom.* *Hirschkop v. Snead*, No. 76-2016 (4th Cir. Mar. 2, 1979). For a statement of the court of appeals' holding, see note 106 *supra*.

111. *Id.* at 1145-46.

112. *Id.* at 1148.

113. *Id.* at 1155.

114. 413 U.S. 548 (1973).

115. *Id.* at 579, *quoted with approval in* *Hirschkop v. Virginia State Bar*, 421 F. Supp. at 1148.

that which should be applied to rules that may be the basis for "quasi-criminal" disciplinary action against a lawyer.¹¹⁶

The *Hirschkop* court further relied on a presumption that the rule would apply only to experienced trial lawyers. In one of the more cogent statements of the idea that legal history and traditions supply the content for otherwise vague rules, the court opined: "The use and meaning of the word 'reasonable' is as familiar to a lawyer as is the meaning of the word 'faith' to a priest. Both are difficult to define but a lawyer knows what reasonable means just as a priest knows what faith means."¹¹⁷ Since even a priest could hardly deny that "faith" means something different to each individual, this is actually a compelling statement of the case for replacing "reasonable" as the key word marking the boundary between permissible and punishable speech.

Not only does the present formulation fail to give adequate notice of forbidden conduct, because reasonable attorneys would disagree about what statements would be reasonably likely to interfere with a fair trial, but its vague terms invite arbitrary and discriminatory enforcement against controversial attorneys in this sensitive area. In fact, a pretrial settlement in the *Hirschkop* case itself included an acknowledgement by the Virginia State Bar that the grounds of the past charges against *Hirschkop* under DR 7-107 did not actually constitute violations, but appeared to have arisen in cases in which the complainants disagreed with the causes supported and espoused by the accused attorney.¹¹⁸ Finally, the *Bauer* court properly considered the public interest to be a factor in its decision. It emphasized the public's right to know, and pointed to the usefulness of attorneys as informed, credible sources of information on pending litigation and as potential checks on government abuses.¹¹⁹ As long as the accused's right to a fair trial receives full protection, which it would under a "serious and imminent threat" standard, it is in the public's interest to receive as much information as possible, from all sources, about the operation of the judicial system. Thus the public interest factor, in addition to the other considerations that should affect the analysis of vagueness in the Code, indicate that DR 7-107 should be subjected to the most exacting standard of specificity, and under that standard should be found unconstitutionally vague.

116. See notes 56-71 and accompanying text *supra*.

117. 421 F. Supp. at 1148.

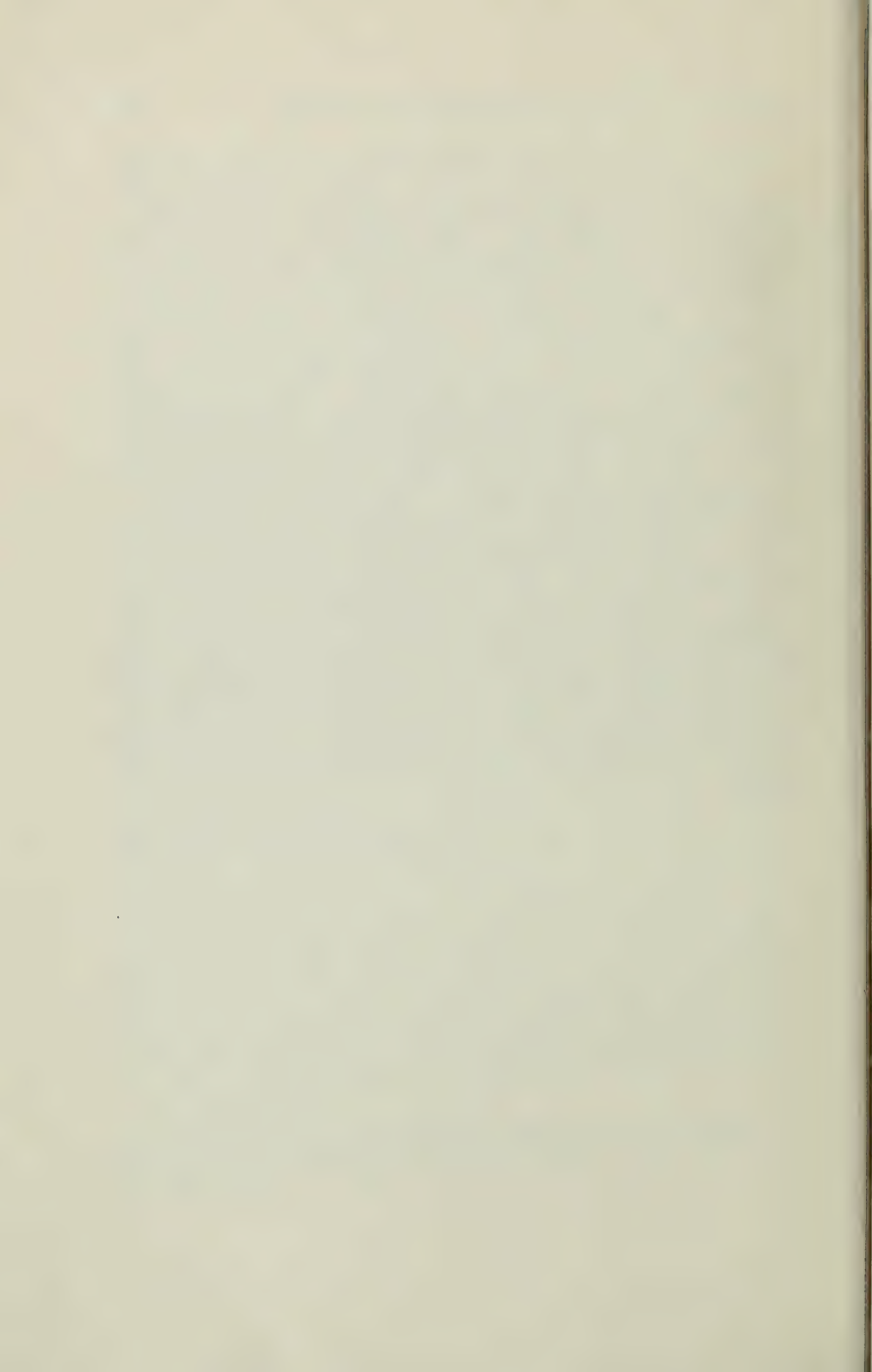
118. *Id.* at 1140. As a result, the charges had been dropped, and on this acknowledgment, all parties defendant in the present suit were dropped except the Supreme Court of Virginia. The court then took jurisdiction of the declaratory judgment action alone.

119. 522 F.2d at 250.

IV. CONCLUSION

The ABA Code of Professional Responsibility, which is designed to regulate the legal profession by delineating approved and forbidden conduct, frequently does so in inappropriately broad terms. As a result, there is a significant possibility that attorneys may be disbarred or otherwise disciplined for actions they did not perceive to be unethical or violative of a disciplinary rule. The lack of precision in the rules also allows selective enforcement of their provisions if state bar committees are so inclined, and may result in curtailment of attorneys' first amendment rights to a greater extent than the necessary minimum. When these dangers are placed alongside the severity of possible sanctions for violations of the rules, the need for greater clarity is apparent. Though the public may require protection from unethical lawyers, this goal can be accomplished as effectively with precise rules as with vague ones. Thus, the fundamental policies of the void-for-vagueness doctrine as it has developed in the United States Supreme Court lead to the conclusion that some of the disciplinary rules of the Code should be declared unconstitutionally vague. The federal courts, however, are traditionally reluctant to interfere in this sphere, which is considered to be the prerogative of the states to control. Court decisions actually voiding the rules for vagueness are therefore unlikely unless wholesale violations of attorneys' constitutional rights begin to occur. The ABA should not wait for that unlikely eventuality, however, but should itself confront the problem by eliminating unnecessary vagueness from the Code.

MARTHA ELIZABETH JOHNSTON



NOTE

Employment Discrimination—*Weber v. Kaiser Aluminum & Chemical Corp.*: Does Title VII Limit Executive Order 11246?

In November 1977 a decision that could seriously retard affirmative action taken to remedy employment discrimination was issued by the United States Court of Appeals for the Fifth Circuit, a court long-noted for its progressive decisions in the area of civil rights. In *Weber v. Kaiser Aluminum & Chemical Corp.*,¹ the court struck down a plan implemented by Kaiser that guaranteed a fifty percent minority admission ratio into a craft apprenticeship program. The decision is the most recent attempt by a federal court of appeals to interpret the possibly conflicting provisions of Executive Order 11246,² which demands that government contractors take affirmative action to benefit minorities and women, and Title VII of the Civil Rights Act of 1964,³ which prohibits race and sex discrimination in employment.⁴ Before *Weber* all federal courts of appeals confronting the issue had sustained the legality of specific affirmative action plans instituted under the authority of the Executive Order, despite the antidiscrimination provisions of title VII.⁵ In *Weber*, however, the court held that Executive Order 11246

1. 563 F.2d 216 (5th Cir. 1977), *cert. granted*, 47 U.S.L.W. 3408 (U.S. Dec. 12, 1978) (No. 78-435).

2. Exec. Order No. 11,246, *as amended* by Exec. Order No. 11,375 & Exec. Order No. 11,478, 3 C.F.R. 173 (1973), *reprinted* in 42 U.S.C. § 2000e app., at 1232-36 (1976), *and as further amended* by Exec. Order No. 12,086, 43 Fed. Reg. 46,501 (1978).

3. Pub. L. No. 88-352, tit. VII, 78 Stat. 241 (codified as amended at 42 U.S.C. §§ 2000e to 2000e-15 (1976), *quoted in part* in notes 45-48 *infra*).

4. The potential conflict has generated considerable debate. *See generally* Blumrosen, *Quotas, Common Sense, and Law in Labor Relations: Three Dimensions of Equal Opportunity*, 27 RUTGERS L. REV. 675 (1974); Edwards & Zaretsky, *Preferential Remedies for Employment Discrimination*, 74 MICH. L. REV. 1 (1975); Jones, *The Bugaboo of Employment Quotas*, 1970 WIS. L. REV. 341; Leiken, *Preferential Treatment in the Skilled Building Trades: An Analysis of the Philadelphia Plan*, 56 CORNELL L. REV. 84 (1970); Morgan, *Achieving National Goals Through Federal Contracts: Giving Form to an Unconstrained Administrative Process*, 1974 WIS. L. REV. 301; Slate, *Preferential Relief in Employment Discrimination Cases*, 5 LOY. CHI. L.J. 315 (1974); Sape, *The Use of Numerical Quotas to Achieve Integration in Employment*, 16 WM. & MARY L. REV. 481 (1975); Venick & Lane, *Doubling the Price of Past Discrimination: The Employer's Burden After McDonald v. Sante Fe Trail Transportation Co.*, 8 LOY. CHI. L.J. 789 (1977); Comment, *How Far Can Affirmative Action Go Before It Becomes Reverse Discrimination?*, 26 CATH. U.L. REV. 513 (1977); Note, *A Proposal for Reconciling Affirmative Action with Nondiscrimination Under the Contractor Antidiscrimination Program*, 30 STAN. L. REV. 803 (1978).

5. *See* EEOC v. American Tel. & Tel. Co., 556 F.2d 167 (3d Cir. 1977), *cert. denied*, 98 S. Ct. 3145 (1978); Mele v. EEOC, 532 F.2d 747 (3d Cir. 1976), *aff'g mem.* Mele v. United States

violates title VII if it mandates the use of a racial quota in the absence of prior discrimination by the employer.⁶

The legal precedent, legislative history, and policy reasons supporting an employer's use of a quota to comply with the Executive Order will be analyzed in this Note. These issues were largely unexplored by the *Weber* majority. In addition, an analysis of the validity of using quotas in the absence of findings of discrimination will be undertaken. This issue was raised both in *Weber* and in the Supreme Court's later decision in *Regents of the University of California v. Bakke*.⁷ Both decisions draw attention to the problems inherent in distinguishing between employer discrimination and societal discrimination when judging the legality of affirmative action plans in employment.

BACKGROUND

In 1974, Kaiser Aluminum negotiated a collective bargaining agreement with the United Steelworkers Union that established a new on-the-job training program within designated plants to increase the participation of minorities in the highly paid craft positions. Previously, Kaiser's official policy was to consider only workers with craft experience outside the plant for craft apprentice and craft positions.⁸ Minority workers, who had been discriminated against by outside unions, had no prior experience to qualify them for craft positions.⁹ Because of this outside discrimination, and possible discrimination by Kaiser itself,¹⁰ at Kaiser's Gramercy plant blacks held less than 2% of the craft positions, although they constituted 39% of the surrounding labor force.¹¹ Under pressure from the Office of Federal Contract

Dep't of Justice, 395 F. Supp. 592 (D.N.J. 1975); *Southern Ill. Builders Ass'n v. Ogilvie*, 471 F.2d 680 (7th Cir. 1972); *Contractors Ass'n v. Secretary of Labor*, 442 F.2d 159 (3d Cir.), *cert. denied*, 404 U.S. 854 (1971). *See also* *Associated Gen. Contractors, Inc. v. Altshuler*, 490 F.2d 9 (1st Cir. 1973), *cert. denied*, 416 U.S. 957 (1974) (upholding Governor's executive order similar to Exec. Order 11,246).

6. 563 F.2d at 227. *Weber* presents two important issues: whether a quota that is voluntarily implemented to remedy possible title VII violations is legal; and whether, regardless of any title VII violations, a quota that is voluntarily implemented under the authority of Exec. Order 11246 is legal. Although the second issue is the focus of this Note, the issues are not separable, since most quotas implemented to comply with the Executive Order also remedy arguable title VII violations. *See* notes 26 & 27 and accompanying text *infra*.

7. 98 S. Ct. 2733 (1978).

8. 563 F.2d at 218.

9. *Id.* at 234, 237 (dissenting opinion).

10. *See* notes 17 & 26 *infra*.

11. Prior to 1974 only 5 of 273 craft positions were held by blacks. Petition for Writ of Certiorari on behalf of the United States and the Equal Employment Opportunity Commission at 3.

Compliance (OFCC), which enforces the Executive Order¹² to remedy the underrepresentation of minorities, Kaiser and the union negotiated an agreement that established a new in-plant training program.¹³ Qualified white and black workers who previously had not met the prior experience requirement were to be admitted in a one-to-one ratio on the basis of seniority, with separate seniority lists maintained for the two groups. Weber, a white male, sued when a black with less seniority than he had was admitted into the program.¹⁴

The evidence presented to the district court was sparse. Two Kaiser officials testified that Kaiser had not discriminated in the past, but that past discrimination against blacks by outside craft unions justified the imposition of the racial quota.¹⁵ The statistics showing Kaiser's underutilization of minorities were never analyzed by the court,¹⁶ nor were OFCC findings concerning Kaiser's previous discrimination introduced.¹⁷

The district court held that the Kaiser quota was illegal because title VII only permits quotas when they are imposed by the courts after judicial determinations of discrimination.¹⁸ Alternatively, the district court held that Kaiser had not discriminated and thus the quota would have been illegal even had it been imposed by a court.¹⁹ In light of its finding that Kaiser had not discriminated, the court found that the Executive Order and title VII were in conflict, since the Executive Order seemed to require employers who had not discriminated to give preferential treatment to minorities.²⁰

12. Exec. Order 11246 authorizes the Secretary of Labor to adopt such rules and regulations as may be appropriate to administer the Order. Exec. Order No. 11,246, § 201, 3 C.F.R. 173, 174 (1973). Pursuant to authority granted in the Executive Order, the Secretary has delegated this authority to the Director of the Office of Federal Contract Compliance. *Id.* § 401, 3 C.F.R. 173, 181 (1973); 41 C.F.R. § 60-1.2 (1978).

13. Similar agreements were made throughout the aluminum industry. 563 F.2d at 218. The affirmative action provisions in these agreements mirrored provisions in a nationwide steel settlement that had been previously approved by the Fifth Circuit in *United States v. Allegheny-Ludlum Indus., Inc.*, 517 F.2d 826 (5th Cir. 1975), *cert. denied*, 425 U.S. 944 (1976).

14. 563 F.2d at 218.

15. *Id.* at 224.

16. *Id.* at 231 (Wisdom, J., dissenting).

17. In 1971, following a compliance review, OFCC found that Kaiser was guilty of discrimination. In 1973, OFCC found that Kaiser had waived its prior experience requirements for whites but not for blacks who had applied for craft positions. These findings were revealed by the Government, and were never brought out by Kaiser. Petition for Certiorari on behalf of the United States and the Equal Employment Opportunity Commission at 18.

18. 415 F. Supp. 761, 767-68 (E.D. La. 1976), *aff'd*, 563 F.2d 216 (5th Cir. 1977), *cert. granted*, 47 U.S.L.W. 3408 (U.S. Dec. 12, 1978) (No. 78-435).

19. *Id.* at 769.

20. *Id.*

The court of appeals affirmed, one judge dissenting. The majority disagreed with the district court's holding that only judicially imposed quotas are legal.²¹ It affirmed, however, on the basis of the alternate holding,²² stating that in the absence of prior employment discrimination, a racial quota "loses its character as an equitable *remedy* and must be banned as an unlawful racial *preference* prohibited by Title VII."²³ Like the district court, the court of appeals found that the Executive Order could not validate the quota. Invoking Justice Jackson's separation-of-powers analysis in *Youngstown Sheet & Tube Co. v. Sawyer*,²⁴ the court reasoned that if the Executive Order authorizes the use of a racial quota in the absence of prior employment discrimination it contravenes congressional intent as expressed in title VII, and therefore is illegal.²⁵

In a strong dissent, Judge Wisdom argued that Kaiser's affirmative action program was legal, both as a reasonable remedy for Kaiser's own arguable violations of title VII²⁶ and as a permissible voluntary action to remedy the effects of past societal discrimination.²⁷ With regard to the Executive Order issue, Judge Wisdom noted that in 1972 Congress had implicitly affirmed the Executive Order, thereby exempting it from title VII.²⁸ He concluded, however, that the case should be

21. 563 F.2d at 223.

22. *Id.* at 224. The district court's finding that Kaiser was not guilty of discrimination apparently was based on the testimony of two Kaiser officials. The finding is questionable. As Judge Wisdom argued, no litigant in the original proceeding wanted to prove any past discrimination by Kaiser, and no one represented the interests of the minorities at Kaiser, the only persons who were interested in showing the existence of past discrimination. *Id.* at 231 (dissenting opinion).

23. *Id.* at 224.

24. 343 U.S. 579 (1952), *cited in* 563 F.2d at 227. In *Youngstown*, Justice Jackson defined three categories of presidential powers. According to Justice Jackson, the President's power is greatest when he acts pursuant to express or implied congressional authorization. When the President acts in absence of a congressional authorization, he acts in a "twilight zone" in which both he and Congress may exercise concurrent authority. When the President takes measures that are incompatible with the express or implied will of Congress, his powers are only what he alone possesses, and the action can be upheld only if the Constitution has delegated the authority to the President, and not to Congress. *Id.* at 636-38.

25. 563 F.2d at 227.

26. *Id.* at 230 (dissenting opinion). Kaiser's arguable title VII liability was based on (1) a *prima facie* case of discrimination, proven by the gross statistical underrepresentation of minorities in both its general labor force and its skilled positions, (2) the prior experience requirement for the limited craft training program that existed before 1974, and (3) the requirement that persons hired for craft positions have previous training. *Id.* at 231-32 (dissenting opinion).

27. *Id.* at 234-36 (dissenting opinion).

28. *Id.* at 237-38 (dissenting opinion); *see* notes 80-92 and accompanying text *infra*.

remanded to the district court to determine whether the quota employed by Kaiser violated the Order itself,²⁹ and if it did not, whether federal authorization of such a quota violates the Constitution.³⁰

THE EXECUTIVE ORDER AND TITLE VII

The Executive Order program predates the effective date of title VII by twenty-four years. Since 1941, successive Presidents have issued executive orders prohibiting employment discrimination by government contractors and subcontractors.³¹ For twenty years contractors and subcontractors were merely required to follow a policy of nondiscrimination. In 1961, however, President Kennedy added the obligation to take "affirmative action."³² This requirement was extended by

29. *Id.* at 238 (dissenting opinion). OFCC regulations contain a disclaimer of any intent to impose a quota. 41 C.F.R. § 60-2.12(e) (1978).

30. 563 F.2d at 238 n.24 (dissenting opinion). Judge Wisdom seemed to be questioning on equal protection grounds the general constitutionality of any federal authorization for government contractors to utilize quotas.

31. The major executive orders dealing with the obligations of government contractors and subcontractors are Exec. Order No. 8802, 3 C.F.R. 957 (1938-1943 Compilation); Exec. Order No. 9346, 3 C.F.R. 1280 (1938-1943 Compilation) (President Roosevelt); Exec. Order No. 10,308, 3 C.F.R. 837 (1949-1953 Compilation) (President Truman); Exec. Order No. 10,479, 3 C.F.R. 961 (1949-1953 Compilation) (President Eisenhower); Exec. Order No. 10,557, 3 C.F.R. 203 (1954-1958 Compilation); Exec. Order No. 10,925, 3 C.F.R. 448 (1959-1963 Compilation); Exec. Order No. 11,114, 3 C.F.R. 774 (1959-1963 Compilation) (President Kennedy); Exec. Order No. 11,246, 3 C.F.R. 339 (1964-1965 Compilation); Exec. Order No. 11,375, 3 C.F.R. 320 (1966-1970 Compilation) (President Johnson).

President Roosevelt's initial order, Exec. Order 8802, prohibited discrimination in employment on the basis of race, creed, color, and national origin. Exec. Order 11,375, issued in 1967, extended the prohibition to sex discrimination.

Despite the long history of the Executive Order program, there is no clear statutory grant of authority that gives the President the power to impose any requirements on government contractors that are unnecessary to the management and procurement of goods or services. One court that has analyzed the basis of presidential authority has found that the Executive has the power to further the legitimate government interest in expanding the labor supply as a means of guaranteeing the performance of government contracts. *See Contractors Ass'n v. Secretary of Labor*, 442 F.2d 159, 175 (3d Cir.), *cert. denied*, 404 U.S. 854 (1971); Pasley, *The Nondiscrimination Clause in Government Contracts*, 43 VA. L. REV. 837, 866-68 (1957); Comment, *The Philadelphia Plan: A Study in the Dynamics of Executive Power*, 39 U. CHI. L. REV. 723, 726-32 (1972). Other courts have more candidly asserted that the goal of equal employment itself, aside from any economic benefits, validates Exec. Order 11246. *See Rossetti Contracting Co. v. Brennan*, 508 F.2d 1039, 1045 n.18 (7th Cir. 1975); *Northeast Constr. Co. v. Romney*, 485 F.2d 752, 760 (D.C. Cir. 1973).

For excellent discussions of the limits of presidential power in the area, see Morgan, *Achieving National Goals Through Federal Contracts: Giving Form to an Unconstrained Administrative Process*, 1974 WIS. L. REV. 301, 301-13; Comment, *supra*.

32. Exec. Order No. 10,925, 3 C.F.R. 448 (1959-1963 Compilation).

President Johnson in Executive Order 11246, issued in 1965.³³ Pursuant to authority granted in Executive Order 11246,³⁴ the Secretary of Labor subsequently issued regulations defining the content of "affirmative action."³⁵ These regulations require nonconstruction contractors and subcontractors with fifty or more employees and a contract of \$50,000 with the federal government to develop written affirmative action programs.³⁶ This entails, among other things, conducting a workforce analysis to determine whether minorities or women are "underutilized" in any job category in light of their general availability.³⁷ An employer who finds that minorities or women are underutilized must establish goals and timetables for hiring, training, and promotion to correct the deficiencies.³⁸ In addition, the employer must eliminate unnecessary job prerequisites or qualifications, and "validate," or establish the job-relatedness of employment criteria that are considered essential.³⁹

Neither the Executive Order itself nor OFCC regulations states that minorities or females are to be preferred over other candidates. In

33. Exec. Order No. 11,246, *as amended by* Exec. Order No. 11,375 & Exec. Order No. 11,478, 3 C.F.R. 169 (1976), *reprinted in* 42 U.S.C. § 2000e app. 1332-36 (1976).

The following language is included in all government contracts: "The contractor will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, sex, or national origin." *Id.* § 202, 3 C.F.R. 169, 170 (1976); 41 C.F.R. § 60-1.14(a) (1977).

For a brief history of the development of the executive order program, and the development of the concept of affirmative action, see Note, *Executive Order 11,246: Anti-Discrimination Obligations in Government Contracts*, 44 N.Y.U.L. REV. 590, 590-96 (1969).

34. Exec. Order No. 11,246, § 203(a), 3 C.F.R. 169, 171 (1976).

35. These rules and regulations are found at 41 C.F.R. § 60 (1978). Section 60-1 establishes general rules applicable under the Executive Order. The sections specifically applicable to affirmative action are § 60-2, Revised Order No. 4, which details affirmative action requirements for nonconstruction contractors; § 60-4, which gives requirements for construction contractors; § 60-20, which contains sex discrimination guidelines; and § 60-60, Revised Order No. 14, which contains standard review procedures to determine compliance with affirmative action requirements for nonconstruction contractors.

36. 41 C.F.R. § 60-1.40(a) (1978). The content and design of these programs is set out in Revised Order No. 4, *id.* § 60-2.1 to .32.

37. The employer must apply the following criteria in determining whether minorities are underutilized: (1) the minority population of the labor area surrounding the facility; (2) the size of the minority unemployment force in the labor area surrounding the facility; (3) the percentage of minority work force as compared with the total work force in the immediate labor area; (4) the general availability of minorities having requisite skills in the immediate labor area; (5) the availability of minorities having requisite skills in an area in which the contractor can reasonably recruit; (6) the availability of promotable minority employees within the contractor's organization; (7) the existence of training institutions capable of training minorities in the requisite skills; and (8) the degree of training the contractor is reasonably able to undertake as a means of making all job classifications available to minorities. *Id.* § 60-2.11(b).

38. *Id.* § 60-2.10.

39. *Id.* § 60-2.24.

fact, the Executive Order itself contains a nondiscrimination clause,⁴⁰ and OFCC regulations both disclaim any intent to impose a rigid quota⁴¹ and direct that a goal should not be used to discriminate against any applicant.⁴² However, these prohibitions must be read in light of the OFCC regulations requiring the use of goals. The obvious objective of the goals approach is to broaden an employer's recruitment base and promote the hiring or advancement of minorities or women who may formerly have been considered unqualified or less qualified than competing majority group workers. An effective affirmative action program probably both expands the pool of applicants who are considered equally qualified and affords minorities or females some preference because of their status. This will necessarily be the case whenever the percentage goal of minorities or females to be hired or promoted in a given year actually exceeds that group's percentage in the hiring or promotion pool.⁴³ Additionally, any time a goal is consistently met because the number of qualified minority workers exceeds the goal established, the goal will appear to be a quota.

In light of the obvious objective of the Executive Order program—to eliminate discrimination against minorities and women—the antidiscrimination language in the Order and the regulations should probably be interpreted to afford only constitutional guarantees, rather than absolutely prohibiting preferential treatment.⁴⁴ And considering the goals requirement, the OFCC regulations prohibiting rigid quotas should probably be construed as only prohibiting goals that require the hiring of unqualified persons.

Unlike the Executive Order program, title VII does not demand that employers take any voluntary affirmative action. In fact, although

40. Exec. Order No. 11,246, § 202, 3 C.F.R. 173, 174 (1973).

41. "Goals may not be rigid and inflexible quotas which must be met, but must be targets reasonably attainable by means of applying every good faith effort to make all aspects of the entire affirmative action program work." 41 C.F.R. § 60-2.12(e) (1978).

42. *Id.* § 60-2.30.

43. The following example illustrates this point: Thirty percent of *X*'s workforce of 100 are minority. Only 10% of the supervisors are minority. *X* wants to increase the percentage of supervisors to correct the underutilization of minorities in the supervisory job category, so *X* may implement a 50% ratio for minority promotion and choose minorities for 5 of 10 new supervisory positions. However, assuming that all of *X*'s workforce is basically qualified to be supervisor, normally only 3 of the new supervisors would be minority. Any individual minority enjoys a better chance for promotion than a nonminority—in the above example, a 17% chance compared to a 7% chance.

44. Such a construction is consistent with the Supreme Court's interpretation of the nondiscrimination clause in title VI of the Civil Rights Act, 42 U.S.C. § 2000d (1976). See *Regents of the Univ. of Cal. v. Bakke*, 98 S. Ct. 2733 (1978).

title VII was enacted to prohibit discrimination against minorities, various provisions can be interpreted to prohibit remedial affirmative action favoring minorities. In particular, these provisions are section 703(a), which makes discrimination in hiring and in terms and conditions of employment illegal;⁴⁵ section 703(d), which makes discrimination in training and apprenticeship programs illegal;⁴⁶ section 703(h), which protects "bona fide" seniority systems;⁴⁷ and section 703(j), which provides that title VII shall not be interpreted to require any employer to grant preferential treatment on account of a statistical imbalance between the number of minority workers in the employer's work force and their availability in the labor market.⁴⁸

Prior to *Weber*, the possible conflict between the Executive Order and title VII had been examined in two different contexts. Initial attacks on the Order's validity were made by construction contractors who challenged the imposition of minority hiring goals by the Department of Labor to remedy third-party discrimination by trade unions.⁴⁹

45. 42 U.S.C. § 2000e-2(a) (1976). The provision states:

It shall be an unlawful employment practice for an employer—

(1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or

(2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.

46. *Id.* § 2000e-2(d). The provision states:

It shall be an unlawful employment practice for any employer, labor organization, or joint labor-management committee controlling apprenticeship or other training or retraining, including on-the-job training programs to discriminate against any individual because of his race, color, religion, sex, or national origin in admission to, or employment in, any program established to provide apprenticeship or other training.

47. *Id.* § 2000e-2(h). The provision states:

Notwithstanding any other provision of this subchapter, it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system . . . provided that such differences [*sic*] are not the result of an intention to discriminate because of race, color, religion, sex, or national origin . . .

48. *Id.* § 2000e-2(j). The provision states:

Nothing contained in this subchapter shall be interpreted to require any employer . . . to grant preferential treatment to any individual or to any group because of the race, color, religion, sex, or national origin of such individual or group on account of an imbalance which may exist with respect to the total number or percentage of persons of any race, color, religion, sex, or national origin employed by any employer . . . in comparison with the total number or percentage of persons of such race, color, religion, sex, or national origin in any community, State, section, or other area, or in the available work force . . .

49. The first use of the "goals and timetables" approach to affirmative action was in 1967 in the construction industry. In an attempt to remedy the virtually complete exclusion of minorities

More recently, various white male plaintiffs have challenged quotas

from the skilled trades the Department of Labor held hearings in different geographic areas to determine the extent of minority underutilization in various skilled trades and to set minimum acceptable ranges for minority utilization. Following these hearings, area-wide plans were imposed in a number of cities. The plans required contractors and subcontractors to commit themselves to goals within acceptable ranges in their bids for government projects. Construction contractors had to commit themselves to minority hiring goals even though outside trade unions were guilty of the prior discrimination. The contractors, in order to meet their goals, were forced either to break their collective bargaining contracts with outside unions, which called for hiring through the hiring hall referral system, or to put pressure on the unions to change their hiring, seniority, and apprenticeship provisions to elevate minority tradesmen to skilled worker status within a shortened time period. The first construction industry plan to use the goals and timetables approach was the Cleveland Plan, which used "manning tables" to increase hiring of minorities. However, the approach was not fully adopted until the Philadelphia Plan was imposed in 1967. As of 1975, there were imposed plans in seven cities. See Leiken, *supra* note 4, at 84-90. The provisions of the imposed plans, along with the Department of Labor findings, are found at 41 C.F.R. § 60-5 to -11 (1977).

In addition, since 1970, voluntary "hometown" plans have been adopted in a number of cities. Voluntary plans are developed by local unions, contractors, and minority groups, and are subsequently reviewed by OFCC regional offices. Hometown plans, like imposed plans, include goals, or ranges of goals for minority utilization. 5 UNITED STATES COMMISSION ON CIVIL RIGHTS, THE FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT, 1974: TO ELIMINATE EMPLOYMENT DISCRIMINATION 345-62 (1975) [hereinafter cited as 5 U.S.C.C.R., 1974: DISCRIMINATION]; Leiken, *supra* note 4, at 91.

In April 1978, extensive revisions to the affirmative action regulations in the construction industry were made. Construction contractors now operate under the same goals and timetables approach as nonconstruction contractors. Imposed plans have been eliminated and hiring goals for women have been set for the first time. See 41 C.F.R. § 60-4.1 to .9 (1978).

For analysis of the various plans, see generally Gould, *The Seattle Building Trades Order: The First Comprehensive Relief Against Employment Discrimination in the Construction Industry*, 26 STAN. L. REV. 773 (1974); Jones, *supra* note 4; Leiken, *supra* note 4; Nash, *Affirmative Action Under Executive Order 11,246*, 46 N.Y.U.L. REV. 225 (1971); Comment, *The Philadelphia Plan and Strict Racial Quotas in Federal Contracts*, 17 U.C.L.A. L. REV. 817 (1970); Note, *Executive Order 11,246: Anti-Discrimination Obligations in Government Contracts*, 44 N.Y.U.L. REV. 590 (1969).

Challenges on both constitutional and statutory grounds to these plans and to similar state plans were raised by contractors and unions. Courts, however, have consistently upheld the plans. See *Associated Gen. Contractors, Inc. v. Altshuler*, 490 F.2d 9 (1st Cir. 1973), *cert. denied*, 416 U.S. 957 (1974) (upholding similar state plan under Governor's executive authority against attack on constitutional grounds and on grounds that plan conflicted with antipreference provision of Massachusetts law similar to title VII); *Southern Ill. Builders Ass'n v. Ogilvie*, 471 F.2d 680 (7th Cir. 1972) (upholding "Ogilvie Plan" against challenge based on Constitution and title VII); *Contractors Ass'n v. Secretary of Labor*, 442 F.2d 159 (3d Cir.), *cert. denied*, 404 U.S. 854 (1971) (upholding "Philadelphia Plan" against challenges based on Constitution, title VI, title VII, and National Labor Relations Act); *Joyce v. McCrane*, 320 F. Supp. 1284 (D.N.J. 1970) (upholding plan against title VII attack); *Weiner v. Cuyahoga Community College Dist.*, 19 Ohio St. 2d 35, 249 N.E.2d 907 (1969), *cert. denied*, 396 U.S. 1004 (1970) (upholding state plan).

Courts have also relied on the Executive Order for legal authority to issue injunctions against unions that impeded the operation of various plans. See, e.g., *United States v. Local 212, IBEW*, 472 F.2d 634 (6th Cir. 1973) (union that continued to discriminate in referrals and membership required to become participant in plan); *United States v. Carpenters Local 169*, 457 F.2d 210 (7th Cir.), *cert. denied*, 409 U.S. 851 (1972) (union forced to issue work permits to minorities trained under federal program rather than under union's apprenticeship program).

contained in the consent decree that ended lengthy government investigation of A.T. & T. following charges of massive employment discrimination.⁵⁰ These quotas provided for the promotion of women and minorities over white males with greater seniority.

In interpreting the provisions of title VII and the Executive Order, courts of appeals have consistently concluded that title VII and the Executive Order are complementary, rather than contradictory.⁵¹ Although title VII was generally interpreted to require race-neutral employment practices, the courts created an exemption from this requirement of race neutrality for racial preferences authorized by the Executive Order. To support this exemption, the courts looked in part to the legislative history and purpose of title VII. For example, in *Contractors Association v. Secretary of Labor*,⁵² the seminal pre-1972 decision, the United States Court of Appeals for the Third Circuit found that Congress did not intend to foreclose remedial affirmative action taken under other authority by passing title VII in 1964.⁵³ Accordingly, the court held that sections 703(h) and (j) did not limit the Executive Order, and that, considering that white workers would not be excluded from any jobs, section 703(a) did not prohibit some minority preference.⁵⁴ More recent decisions have interpreted congressional rejection

50. In 1973, after years of investigation by the EEOC, the Department of Labor, and other government representatives, charges were filed against A.T. & T. under title VII, Exec. Order 11,246, and the Equal Pay Act. Concurrent with the filing of charges, two consent decrees were entered and approved. The decrees provided for a substantial back pay award and for a "seniority override" to accelerate advancement of minority group workers over majority group workers with greater seniority. A.T. & T. disclaimed any past discrimination. Challenges to the decree were raised by unions. The United States Court of Appeals for the Third Circuit upheld the legality under title VII and the constitutionality of the plan in *EEOC v. American Tel. & Tel. Co.*, 556 F.2d 167 (3d Cir. 1977). The Supreme Court, immediately following *Bakke*, denied certiorari. 98 S. Ct. 3145 (1978). Individual plaintiffs passed over because of the seniority override have also challenged the decree under § 703(a) of title VII, 42 U.S.C. § 2000e-2(a) (1976). See *Mele v. United States Dep't of Justice*, 395 F. Supp. 592 (D.N.J. 1975), *aff'd mem.*, 532 F.2d 747 (3d Cir. 1976) (plan was put into effect under authority of the Executive Order, and thus is immune from title VII attack). But see *McAleer v. American Tel. & Tel. Co.*, 416 F. Supp. 435 (D.D.C. 1976) (court would not enjoin valid consent decree but would award plaintiff damages for violation of his statutory rights under § 703(a)). See generally 5 U.S.C.C.R., 1974: DISCRIMINATION, *supra* note 49, at 549-56.

The A.T. & T. consent decrees are reprinted at 8 LAB. REL. REP. (BNA) 431:73 (1978). The decrees expired in January 1979 and were not continued since A.T. & T. was found to have substantially complied with the provisions of the decrees. See *Final Report on A.T. & T.'s Compliance with Consent Decree*, *id.* at 431:124(1).

51. See cases cited notes 49 & 50 *supra*.

52. 442 F.2d 159 (3d Cir.), *cert. denied*, 404 U.S. 854 (1971). The opinion in *Contractors Association* is the most extensive treatment of the statutory issues raised in opposition to the construction industry plans.

53. *Id.* at 171, 173.

54. *Id.* at 172-73.

in 1972 of amendments that would have made goals and quotas expressly illegal⁵⁵ as congressional affirmation that goals and timetables are not prohibited by title VII.⁵⁶

Early decisions upholding the Executive Order were less than candid in analyzing whether the Executive Order can mandate goals or quotas that actually exclude whites from employment opportunities. In general, the construction industry cases tended to ignore the thorny issue of the degree of racial preference authorized under the Executive Order. Some decisions noted that goals would not adversely affect whites.⁵⁷ Others ignored the effect on white workers but stressed that the goals were not rigid, and did not force the hiring of unqualified or less qualified minority workers.⁵⁸ Despite the tendency in early cases to avoid the issue of the effect of goals on white workers, the early cases nevertheless implicitly affirm that some degree of racial preference is authorized by the Executive Order. The clearest support for the use of a goal or quota that has an obvious exclusionary effect is offered by the more recent A.T. & T. litigation, *EEOC v. American Telephone & Telegraph Co.*,⁵⁹ in which strict numerical goals instituted via consent decree were upheld.⁶⁰

Previous Executive Order cases attempted to harmonize the OFCC program and title VII by emphasizing the remedial nature of the challenged goals or quotas and analogizing them to quotas imposed by the judiciary to correct proven title VII discrimination. No decision expressly discussed whether evidence of minority underutilization alone is sufficient to support the conclusion that a goal or quota is properly remedial. Since there was previous administrative consideration of

55. See notes 79-92 and accompanying text *infra*.

56. See, e.g., *EEOC v. American Tel. & Tel. Co.*, 556 F.2d 167, 177 (3d Cir. 1977), *cert. denied*, 98 S. Ct. 3145 (1978).

57. See, e.g., *Contractors Ass'n v. Secretary of Labor*, 442 F.2d at 164, 173 ("Philadelphia Plan" contains assurance that goals are not to be used to discriminate against qualified applicants; Department of Labor made findings that there would be no "adverse impact" on white work force).

58. See, e.g., *Associated Gen. Contractors, Inc. v. Altshuler*, 490 F.2d 9, 18 (1st Cir. 1973), *cert. denied*, 416 U.S. 957 (1974) (some preference to "equally qualified" minorities is legal); *Southern Ill. Builders Ass'n v. Ogilvie*, 471 F.2d 680, 686 (7th Cir. 1972) ("goals" will be interpreted flexibly); *Joyce v. McCrane*, 320 F. Supp. 1284, 1291 (D.N.J. 1970) (goals are not quotas and contractors must only put forth "good faith [effort]" to meet goals in order to avoid sanctions); *Weiner v. Cuyahoga Community College Dist.*, 19 Ohio St. 2d 35, 39, 249 N.E.2d 907, 910 (1969), *cert. denied*, 396 U.S. 1004 (1970) (goal is not quota; quota would violate title VII).

59. 556 F.2d 167 (3d Cir. 1977), *cert. denied*, 98 S. Ct. 3145 (1978), *discussed in note 50 supra*.

60. *Id.* at 174.

the evidence of discrimination in most cases,⁶¹ the decisions can possibly be construed to support preferential treatment only when there has been a previous finding of discrimination.⁶² Before goals were imposed in the construction industry, the Department of Labor held administrative hearings and made findings of exclusionary practices by outside trade unions.⁶³ And negotiation of the consent decree with A.T. & T. required extensive involvement by both the OFCC and the Equal Employment Opportunity Commission (EEOC).⁶⁴ Prior administrative involvement and administrative findings were not essential to prior decisions, however. No decision was expressly conditioned on prior administrative action. Rather, the factor seems to have been only one of many factors the courts cited to support the presumption of actual employment discrimination. In addition, courts noted extreme statistical underrepresentations of minorities in certain trades and cited title VII suits showing discrimination in skilled trades.⁶⁵

In summary, in prior Executive Order decisions, title VII and the Executive Order were considered complementary. Some courts found it necessary to emphasize that whites were not excluded from employment opportunities. The most important factor noted by the courts in harmonizing title VII and the Executive Order, however, was the consonance in the respective purposes of the two programs—the elimination and remedying of discrimination against minorities. Significantly,

61. See e.g., *Southern Ill. Builders Ass'n v. Ogilvie*, 479 F.2d 683, 684 (7th Cir. 1972) ("Ogilvie Plan" involved participation by federal officials; *Contractors Ass'n v. Secretary of Labor*, 442 F.2d at 162-63; *Department of Labor findings of exclusionary practices by unions*; *Dowd v. McCrane*, 326 F.Supp. 1264, 1267, 1269, 1281 (D.N.J. 1970) (OFCC hearings resulted in findings that some unions guilty of exclusionary practices)."

62. See e.g., *Associated Gen. Contractors, Inc. v. Altshuler*, 490 F.2d 9, 13 (6th Cir. 1973), cert. denied, 415 U.S. 957 (1974) (long history of racial discrimination in construction unions; *Southern Ill. Builders Ass'n v. Ogilvie*, 479 F.2d 683, 684 (7th Cir. 1972) (previous title VII suit showing history of discrimination in highway construction; *Contractors Ass'n v. Secretary of Labor*, 442 F.2d at 162-63, 173 (orders issued by Department of Labor found prior exclusionary practices by unions; *Dowd v. McCrane*, 326 F.Supp. 1264, 1267, 1269, 1290, 1281 (D.N.J. 1970) (evidence of near total minority exclusion in certain trades and government findings that "some unions are guilty of exclusionary practices").

63. Summaries of the findings made prior to the development of the imposed plans are found at 40 C.F.R. § 60-1.10-13 (1977). Significantly, Department of Labor hearings were *not* held before the development of the numerous hometown plans discussed in note 48 *supra*.

64. Investigation of charges against A.T. & T. took over two years. The EEOC was involved to a much greater degree than the OFCC. 41 EEOC investigative task force put 13.3 person-years into compiling a preliminary report issued in December 1971, over one year before the consent decree was signed. 1 U.S.C. § 1974 (DISCRIMINATION, *supra* note 28, at 140-12, 150 (1974)).

65. See e.g., *Associated Gen. Contractors, Inc. v. Altshuler*, 490 F.2d 9, 13 (6th Cir. 1973), cert. denied, 415 U.S. 957 (1974) (low percentage of minorities is evidence of discrimination; *Southern Ill. Builders Ass'n v. Ogilvie*, 479 F.2d 683, 684 (7th Cir. 1972) (statistical underrepresentation in trades compared to demographic statistics shows discrimination).

no court made any findings of title VII discrimination,⁶⁶ nor did any court insist that the party instituting the goals be the discriminating party. Finally, no court required that the beneficiaries of the goals be persons who were, in fact, discriminated against. In contrast to the *Weber* court's conclusion that only "actual" title VII discrimination on the part of the employer can legalize the use of a goal,⁶⁷ prior cases support the legality of goals whenever they are used to remedy any arguable employment discrimination.

CONGRESSIONAL CONSIDERATION OF TITLE VII AND THE EXECUTIVE ORDER

In determining that remedial action taken under the authority of the Executive Order is limited by title VII, the *Weber* majority ignored the possibility of congressional ratification of the Executive Order.⁶⁸ Yet, interpretation of congressional consideration of the Executive Order in 1964 and in 1972 is significant. Even if sections 703 (a) and (d) of title VII are interpreted to require racial neutrality, congressional ratification could make actions taken in compliance with the Executive Order exempt from these sections. Congressional ratification would also indicate congressional approval of the goal of remedying discrimination, whatever the source, through the imposition by the OFCC of race-conscious affirmative action obligations on employers that have not been adjudged guilty of any title VII violations.

Legislative history of the Civil Rights Act of 1964 offers only slight support for the use of remedial racial preferences in any circumstance.

66. "Title VII discrimination" differs from discrimination that violates the Executive Order. Title VII protects "bona fide" seniority systems. Title VII also allows no remedy for discrimination occurring prior to 1965. The Executive Order, on the other hand, contains no exemption for bona fide seniority systems, and is not limited in time.

Although the Department of Labor made findings of "exclusionary practices" in the construction cases, these findings were not made pursuant to adjudication of title VII issues. The Department of Labor findings were based primarily on the virtual total exclusion of minorities from certain trades, as shown by statistics. Jones, *supra* note 4, at 368; Nash, *supra* note 49, at 232; See, e.g., 41 C.F.R. § 60-5.10 (1977). Such a statistical showing is only a prima facie title VII violation, and can be rebutted by evidence of business necessity or the operation of a bona fide seniority system. It is true that, had there been a court adjudication, the unions would probably have been found guilty of title VII discrimination. The important fact, however, is that none of the courts themselves considered it necessary to make a finding of actual title VII discrimination in order to legalize the challenged goals.

67. 563 F.2d at 224, 226, 227.

68. Judge Wisdom, in contrast, relied on congressional ratification in 1972 to support his theory that Congress has exempted the Executive Order from title VII. 563 F.2d at 237-38 (dissenting opinion).

In fact, it appears that the Congress thought that section 703(j),⁶⁹ which states that title VII does not *require* employers to use preferences to remedy statistical imbalances, would prohibit even court-ordered quotas.⁷⁰ Goals imposed by the Executive Order were not explicitly considered since the general affirmative action requirement had only recently been added by President Kennedy, and since the goals and timetables approach was not yet in use.⁷¹ Two implications can, however, be drawn from the language of 703(j) that offer some support for an employer's voluntary use of a remedial preference. The first is that the very passage of section 703(j) demonstrates that there was no clear consensus about whether sections 703(a) and (d) would in themselves prohibit racial preferences for minorities.⁷² The second is that, although title VII might not *require* employment preferences for minorities, employers might use them voluntarily. Although both of these interpretations contradict remarks made while title VII was being debated,⁷³ they are not unsupportable, considering that the main concern of the 1964 Congress was to eliminate racial discrimination against blacks and not to legislate on the permissibility of using remedial preferences.⁷⁴

69. 42 U.S.C. § 2000e-2(j) (1976), *quoted in* note 48 *supra*.

70. *See, e.g.*, 110 CONG. REC. 6549 (1964) (remarks of Sen. Humphrey):

Contrary to the allegations of some opponents of this title, there is nothing in it that will give any power to the Commission or to any court to require hiring, firing, or promotion of employees in order to meet a racial "quota" or to achieve a certain racial balance.

That bugaboo has been brought up a dozen times; but it is nonexistent. In fact, the very opposite is true. Title VII prohibits discrimination.

See also id. at 8921 (remarks of Sen. Williams).

71. The obligation to take "affirmative action" was added in 1961 by Exec. Order No. 10,925, § 301, 3 C.F.R. 448, 449-50 (1959-1963 Compilation). Goals and timetables were not used in the construction industry until 1967. *See* note 49 *supra*. They were made a general requirement for all contractors and subcontractors in 1968. *See* 41 C.F.R. § 60-1.40 (1978) (originally became effective on July 1, 1968, 33 Fed. Reg. 7804 (1968)). The more detailed affirmative action requirements for nonconstruction contractors contained in Order No. 4, now Revised Order No. 4, became effective in 1970. *See* 41 C.F.R. § 60-2 (1978), *originally issued in* 35 Fed. Reg. 2586 (1970).

72. *Cf. Regents of the Univ. of Cal. v. Bakke*, 98 S. Ct. at 2780-82 & 2781 n.28, 2772-74 (Brennan, White, Marshall & Blackmun, J.J., concurring in part and dissenting) (similar interpretation of title VI).

73. *See* note 70 *supra*. *See also* Interpretative Memorandum of Title VII of H.R. 7152, submitted jointly by Senators Clark and Case:

There is no requirement in Title VII that an employer maintain a racial balance in his work force. On the contrary, any deliberate attempt to maintain a racial balance, whatever such balance may be, would involve a violation of Title VII because maintaining such a balance would require an employer to hire or refuse to hire on the basis of race.

110 CONG. REC. 7212, 7213 (1964).

74. For a similar interpretation of title VI, *see Regents of the Univ. of Cal. v. Bakke*, 98 S. Ct. at 2746-47 (intent of Congress in passing title VI in 1964 was to prohibit discrimination against

Despite the language of sections 703(a), (d), and (j), courts have regularly used quotas to remedy proven title VII discrimination.⁷⁵ In doing so, courts have relied on the argument that the scope of remedial power granted to courts in section 706(g)⁷⁶ is not limited by the language in section 703.⁷⁷ The Supreme Court has not considered this interpretation with regard to quotas, but it has accepted the theory in granting seniority relief.⁷⁸ Aside from the absence of express limitation on the court's remedial powers in section 706(g), the primary support for the use of quotas by the judiciary comes from actions taken by Congress in the course of passing the Equal Employment Opportunity Act of 1972,⁷⁹ which amended the Civil Rights Act of 1964. At that time the Senate voted down an amendment that would have specifically prohibited the imposition of goals or quotas by government agencies, including perhaps the courts.⁸⁰ Rejection of this amendment has been

blacks). See generally Vaas, *Title VII: Legislative History*, 7 B.C. INDUS. & COM. L. REV. 431 (1966).

75. See, e.g., *Boston NAACP v. Beecher*, 504 F.2d 1017, 1026-27 (1st Cir. 1974) (upholding ratio hiring until minority percentage in work force equals minority percentage in labor force); *NAACP v. Allen*, 493 F.2d 614 (5th Cir. 1974) (upholding one to one hiring ratio until blacks reach 25% of work force); *United States v. N.L. Indus. Inc.*, 479 F.2d 354, 377 (8th Cir. 1973) (one to one promotion ratio until 15% of foremen are black); *Pennsylvania v. O'Neill*, 473 F.2d 1029 (3d Cir. 1973) (en banc) (upholding ratio hiring corresponding to black population and number of black applicants); *United States v. Local 212, IBEW*, 472 F.2d 634 (6th Cir. 1973) (upholding 11% black quota in apprenticeship program); *United States v. Carpenters Local 169*, 457 F.2d 210 (7th Cir.), cert. denied, 409 U.S. 851 (1972) (remanding to district court to fashion appropriate affirmative relief); *United States v. Ironworkers Local 86*, 443 F.2d 544, 553 (9th Cir.), cert. denied, 404 U.S. 984 (1971) (requiring union training program to select sufficient black applicants to overcome past discrimination. But see *Chance v. Board of Examiners*, 534 F.2d 993 (2d Cir. 1976), cert. denied, 431 U.S. 965 (1977) (quota struck down when whites with greater seniority laid off ahead of blacks with less seniority); *Carter v. Gallagher*, 452 F.2d 315 (8th Cir. 1971) (en banc), cert. denied, 406 U.S. 950 (1972) (court struck down quota that would have resulted in next 20 positions being filled by minorities, but allowed ratio hiring of one black for every two whites).

76. 42 U.S.C. § 2000e-5(g) (1976) provides in relevant part:

If the court finds that the respondent has intentionally engaged in or is intentionally engaging in an unlawful employment practice . . . the court may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay . . . or any other equitable relief as the court deems appropriate.

77. See Comment, *Title VII and Preferential Treatment: The Compliance Dilemma*, 7 TEX. TECH. L. REV. 671, 689-92 (1976).

78. In *Franks v. Bowman Transp. Co.*, 424 U.S. 747 (1976), the Court used the theory that § 703(h), quoted in note 47 *supra*, was only a "definitional" provision that did not limit relief available under § 706(g) in holding that a court generally *must* award retroactive seniority to victims of discrimination. *Id.* at 758-62.

79. Pub. L. No. 92-26, 86 Stat. 103 (codified at 42 U.S.C. §§ 2000e to 2000e-17 (1976)).

80. The amendment, proposed by Senator Ervin, read in part: "No department, agency, or office of the United States shall require any employer to practice discrimination in reverse by employing persons of a particular race . . . in either fixed or variable numbers, proportions, percentages, quotas, goals, or ranges." 118 CONG. REC. 1661 (1972). The amendment was proposed

interpreted as an implicit affirmation that judicial power to remedy discrimination is not limited by section 703.⁸¹

The same legislative history indicates that Congress similarly exempted the Executive Order from the constraints of section 703. In 1972, debate over the goals and timetables approach had been raging for four years. The "Philadelphia Plan," the subject of the *Contractors Association* case,⁸² had received great attention. The Comptroller General declared the plan illegal in 1969. The Attorney General subsequently issued an opinion upholding the legality of the plan.⁸³ A rider that would have cut off funding for any project that the Comptroller General declared illegal was defeated by Congress in 1969.⁸⁴ Both imposed and voluntary plans incorporating goals and timetables were in use in the construction industry,⁸⁵ and regulations requiring nonconstruction contractors to utilize goals and timetables had been in effect since 1968.⁸⁶

In summary, Congress in 1972 clearly understood that the OFCC, in the absence of any findings of title VII violations, was forcing employers to adopt or accept race-conscious goals as a remedy either for their own discrimination or for discrimination by outside parties. This was the context then in which both the House⁸⁷ and the Senate⁸⁸ defeated amendments that would have explicitly abolished the use of

primarily as a means of banning the use of goals under the Executive Order, *id.* at 1663, although opponents, attempting to defeat the amendment, stressed that it could restrict the use of quotas by courts as well, *id.* at 1665-75. In speaking against the amendment, Senator Javits quoted from the opinion in *Contractors Association* and had the opinion printed in the record. *Id.* at 1665-76. The amendment was soundly defeated, 22 to 44. *Id.* at 1676.

81. For example, this legislative history was cited by the *Weber* majority to support the fact that quotas may be imposed by courts. 563 F.2d at 220. See *EEOC v. American Tel. & Tel. Co.*, 556 F.2d at 177; *United States v. International Union of Elevator Constructors*, 538 F.2d 1012, 1019-20 (3d Cir. 1976).

82. See note 49 *supra*.

83. See note 97 *infra*.

84. The Fannin rider was specifically intended to stop the imposition of goals and timetables in the construction industry. The rider was passed by the Senate, 115 CONG. REC. 40,039 (1969), defeated by the House, *id.* at 40,921, and, upon reconsideration, defeated by the Senate, *id.* at 40,749. See Comment, *supra* note 31 at 748-50 (author sees vote as qualified support for ratification of Executive Order through appropriation).

85. See note 49 *supra*.

86. See note 71 *supra*.

87. Consideration of the quota issue in the House was not as clear-cut as it was in the Senate. The Dent amendment, which would have combined the EEOC and the OFCC and prohibited the EEOC from using quotas or preferential treatment, was added to the Hawkins-Reed bill, the bill that was reported out of Committee. A substitute bill, the Erlenborn-Mazzoli bill, was offered from the floor. The Hawkins bill gave the EEOC authority to issue cease and desist orders, whereas the Erlenborn substitute only gave the EEOC authority to prosecute suits in the federal courts. The issue of the EEOC's enforcement power was actually the critical point of difference between the bills, but the quota issue was also important in the debate. Congressman Dent, before

goals and timetables under the Executive Order. Debate in the Senate, in particular, indicates that supporters and opponents of the OFCC program understood that the Executive Order was not operating within the constraints of title VII.⁸⁹ The Senate also voted down two amendments that could have diluted or destroyed the unique affirmative action components of the OFCC program.⁹⁰ Debate over these amendments clearly demonstrates congressional understanding that

the vote on the Erlenborn substitute, decided not to offer any amendments to the substitute so that the House would have a choice between a bill that would continue the OFCC's imposition of quotas, the Erlenborn substitute, and a bill that would prohibit quotas, the Hawkins bill. SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, LEGISLATIVE HISTORY OF THE EQUAL EMPLOYMENT OPPORTUNITY ACT OF 1972, at 275-77 [hereinafter cited as 1972 LEGISLATIVE HISTORY] (remarks of Congresswoman Abzug) (summary of differences in the bills); *id.* at 254-56 (remarks of Congressman Dent) ("the two bills offer a clear-cut choice for and against quotas"). Ironically, many liberals supported the Hawkins bill, despite the inclusion of the Dent amendment, since it gave the EEOC stronger enforcement authority. The Erlenborn substitute, without the Dent amendment, was accepted by the House, 202 to 194. *Id.* at 312.

88. The Senate defeated two amendments offered by Senator Ervin. The first would have prohibited any government agency from using goals or quotas. *See* note 80 *supra*. The second amendment would have specifically applied only to the Executive Order and not to the courts. It would have amended § 703(j) to read: "Nothing contained in this title or in Executive Order No. 11246, or in any other law or Executive Order, shall be interpreted to require any employer . . . to grant preferential treatment . . ." 118 CONG. REC. 4917 (1972) (emphasis added). It was defeated, 30 to 60. *Id.* at 4918; *see* Comment, *supra* note 31, at 754-57.

89. *See, e.g.*, 118 CONG. REC. 1386 (1972) (remarks of Sen. Saxbe) (discussing a different amendment, stating that the Executive Order is independent of title VII and not subject to its more restrictive provisions); *id.* at 4918 (remarks of Sen. Javits) (noting that federal government is not limited by title VII if title VII requires color-blindness); *id.* at 4918 (remarks of Sen. Ervin) (stating that the Executive Order is not, but should be, operating within limits of title VII).

90. Two amendments were proposed. The first amendment, which was defeated, would have transferred the OFCC program to the EEOC. Senator Saxbe, speaking against the amendment, stated:

The "affirmative action" concept is the mainstay of the Executive Order program . . .

. . . The OFCC has utilized the proven business technique of establishing "goals and timetables" to insure the success of the Executive Order program. It has been the "goals and timetables" approach, which is unique to the OFCC's efforts in equal employment, coupled with extensive reporting and monitoring procedures that has given the promise of equal employment opportunity a new credibility.

. . . The Executive Order program should not be confused with the judicial remedies for proven discrimination which unfold on a limited and expensive case-by-case basis. Rather, affirmative action means that all Government contractors must develop programs to insure that all share equally in the jobs generated by the Federal Government's spending. *Proof of overt discrimination is not required.*

Id. at 1385 (1972) (emphasis added).

Senator Saxbe also noted that violations of the Executive Order might be found when there were no violations of title VII. Finally, he expressed concern that merging the OFCC and the EEOC would result in renewed challenges to plans such as the Philadelphia Plan. *Id.* at 1386.

Congress also defeated an amendment that would have made title VII the exclusive federal remedy for certain individuals. *Id.* at 3367-73, 3959-65. In opposing the amendment, Senator Williams, one of the floor managers of the 1972 Act, noted that it could "bar enforcement of the Government contract compliance program . . . I cannot believe that the Senate would do that after all the votes we have taken in the past 2 or 3 years to continue that program in full force and effect." *Id.* at 3372.

government contractors were being forced to take affirmative action that was not required by title VII. These and other actions⁹¹ provide, as one court has found, "unusually clear evidence" that Congress in 1972 recognized the existence of the Executive Order program, including its goals and timetables requirements, and rejected efforts to restrict or eliminate it.⁹²

Congressional ratification of the Executive Order does not necessarily mean that an employer's use of a quota to comply with OFCC regulations is legal, however. It is possible that congressional ratification could not effectively exempt the Executive Order from title VII. And regardless of whether remedial action under the Executive Order is subject to title VII, Congress may not have affirmed the use of quotas. The Supreme Court in *International Brotherhood of Teamsters v. United States*⁹³ indicated that in interpreting a law a court must look primarily to the intent of the Congress that enacted the law. Thus, in holding in *Teamsters* that section 703(h) protects seniority systems that perpetuate pre-1964 discrimination, the Court disregarded the apparent understanding of the 1972 Congress that such systems were not "bona fide" and looked to the contrary intent of the 1964 Congress.⁹⁴ Similar reasoning would dictate that the 1972 Congress could not exempt actions implemented to comply with the Executive Order from sections 703(a) and (d) if the 1964 Congress originally intended those sections to apply to *all* employer action regardless of any governmental authorization.

This result seems extreme, however, especially since if Congress

91. Additional evidence of Senate ratification comes from the section-by-section analysis of the amendments undertaken by the Senate Subcommittee on Labor. With the decision in *Contractors Association* and its holding that §§ 703(a), 703(h), and 703(j) of title VII are not applicable to the Executive Order clearly before the Congress, the subcommittee provided: "In any area where the new law does not address itself, or any areas where a specific contrary intention is not indicated, it was assumed that the present case law as developed by the courts would continue to govern the applicability and construction of Title VII." 1972 LEGISLATIVE HISTORY, *supra* note 87, at 1844.

Finally, Senate affirmation of the Executive Order in 1972 can be inferred from the adoption of two provisions designed to make the program fairer and more efficient. The *Javits* amendment, which became § 715, created the Equal Employment Opportunity Coordinating Council, composed, in part, of the Secretary of Labor and the Chairman of the EEOC to "maximize effort, promote efficiency, and eliminate conflict and inconsistency" among the departments and agencies responsible for equal employment policies. 42 U.S.C. § 2000e-14 (1976). Section 716, requiring a hearing and adjudication before a contract with a contractor who has an approved affirmative action program can be terminated, was also approved. *Id.* § 2000e-17.

92. *United States v. International Union of Elevator Constructors*, 538 F.2d 1012, 1019-20 (3d Cir. 1976).

93. 431 U.S. 324 (1977).

94. *Id.* at 353-54, 354 n.39 (1977).

could not effectively exempt the Executive Order from the operation of section 703 in 1972, neither could it effectively exempt the courts.⁹⁵ Thus all court-imposed quotas would be illegal. In fact, the question whether Congress intended to exempt the courts or the executive branch from title VII's constraints is largely irrelevant if one interprets section 703 to apply only constitutional standards to all remedial affirmative action plans.⁹⁶ If, instead, section 703 embodies a race-neutral standard, however, an exemption for remedial action authorized by the courts or by Executive Order is reasonable, considering that the 1972 Congress gave greater consideration to the issue of affirmative action than did the 1964 Congress.

It can also be argued that congressional ratification of the Executive Order in 1972 did not encompass the use of quotas. The distinction between goals and quotas may be one of semantics, but it was generally voiced in 1972.⁹⁷ Accordingly, it can be argued that Congress

95. See notes 70-81 and accompanying text *supra*.

96. This interpretation was adopted by five justices in *Regents of the Univ. of Cal. v. Bakke*, 98 S. Ct. 2733 (1978). See notes 115-19 and accompanying text *infra*.

97. The Philadelphia Plan and similar plans in the construction trades were the focus of intense debate from 1969 to 1972. The Comptroller General in 1969 ruled that the goals contained within the plans were quotas and were illegal. 49 Comp. Gen. 59 (1969). The Attorney General, in response, issued a statement declaring that the goals did not violate title VII. 42 Op. Att'y Gen. 405 (1969). The gist of the Attorney General's opinion was that race-conscious remedial action does not violate title VII, although totally excluding whites from consideration for positions might be illegal:

The hiring process, viewed realistically, does not begin and end with the employer's choice among competing applicants. The standards he sets for consideration of applicants, the methods he uses to evaluate qualifications, his techniques for communicating information as to vacancies, the audience to which he communicates such information, are all factors likely to have a real and a predictable effect on the racial composition of his work force. Title VII does not prohibit some structuring of the hiring process, such as the broadening of the recruitment base, to encourage the employment of members of minority groups.

Id. at 411.

President Nixon also distinguished between goals and quotas. See Statement by the President Urging Senate and House Conferees to Permit Continued Implementation, 5 WEEKLY COMP. OF PRES. DOC. 1762 (1969) (Philadelphia Plan sets goals, not quotas); President's Radio Address, 8 WEEKLY COMP. OF PRES. DOC. 1343 (1972) (fixed quotas are unfair and are a short-cut to equal opportunity).

The President's statements must be viewed critically since some were made in the context of the President's political "courting" of construction unions. See Gould, *Labor & Nixon: Moving the Hard Hats In*, NATION, Jan. 8, 1973, at 41, cited in W. GOULD, BLACK WORKERS IN WHITE UNIONS: JOB DISCRIMINATION IN THE UNITED STATES 339 n.16 (1977). If President Nixon had wished to assure that goals would not be used as quotas, he could have issued an Executive Order to that effect and definitively settled the controversy. Also, the President objected to quotas because they were a "detour away from measuring a person on the basis of his ability." President's Radio Address, *supra*. However, in any situation where employees are not chosen on the basis of ability or on the basis of a number of factors, but are chosen purely on the basis of seniority, which has little to do with ability, then quotas may be more defensible.

only affirmed the use of goals. The political rhetoric concerning the distinction between goals and quotas should not necessarily be interpreted as an absolute limit on the type of affirmative action permissible under the Executive Order, however. What seems critical is congressional ratification of the concept of affording minorities a remedial preference.⁹⁸ Whether a racial classification assumes the form of an unquantified subjective preference, a quantified weight system, a goal, or a quota may depend largely on the employment context. Hiring goals in the construction industry, which were specifically at issue when Congress rejected amendments to restrict the Executive Order in 1972, were not quotas because the number of available qualified minority workers was unknown.⁹⁹ In a situation like Kaiser's, however, in which the number of qualified available minorities exceeds the goal, the goal will consistently be met and will appear to be a quota. The difference, then, between the construction industry goals that were approved by Congress and the Kaiser quota is in the predictability of the results, and not necessarily in the degree of preference given. Because in many situations the difference between a goal and a quota appears to be merely a rhetorical one, congressional affirmation of the use of racial preferences under the Executive Order should probably be interpreted to include the use of quotas, at least when quotas do not result in the hiring of unqualified workers.

POLICY REASONS FOR ALLOWING A SHOWING OF UNDERUTILIZATION TO VALIDATE AFFIRMATIVE ACTION PLANS

If, as the *Weber* court found, a court must find "actual" title VII discrimination when an employer's voluntary affirmative action program is challenged, voluntary efforts to remedy past discrimination will cease. Employment discrimination law has become a complex science, and no employer can predict with any confidence whether a particular

98. Congress definitely approved the concept of a remedial preference. It would not have been necessary to defeat the second Ervin amendment to title VII, *see* note 88 *supra*, had the Congress thought that the Executive Order did not require *any* preferential treatment. Statements about how the Executive Order was operating outside the constraints of title VII also show that Congress understood that the Executive Order resulted in granting some preference to minorities. *See* note 89 *supra*.

99. *See* note 49 *supra*.

employment practice will be struck down by a court as discriminatory.¹⁰⁰ An employer that knows it will be liable for reverse discrimination unless, when its affirmative action plan is challenged, a court finds that the employer is guilty of actual discrimination, will not institute an affirmative action program at all. A flood of title VII suits by minorities will ensue. Such suits are costly, time-consuming, and are an enormous drain on judicial resources.

Requiring a judicial finding of title VII discrimination also presents an evidentiary problem. Information necessary to make a finding of title VII discrimination will typically not be before the court in a reverse discrimination suit. For example, although Kaiser had an interest in defending itself from Weber's claims of reverse discrimination, it had no interest in being adjudged guilty of discrimination under title VII, which could invite further claims by minorities, or allow the court to fashion additional remedial relief aside from the training quota. Not surprisingly, rather than submitting as evidence OFCC findings that it was guilty of discrimination,¹⁰¹ Kaiser presented oral testimony indicating that it had not discriminated. Such "good faith" declarations are given little weight in title VII suits.¹⁰² Therefore, the district court's determination, accepted by the court of appeals, that Kaiser had not actually discriminated¹⁰³ was not well founded. The court's related proposition that the Kaiser quota was implemented solely to remedy "societal" discrimination¹⁰⁴ is also debatable.

The possibility of using the utilization analysis mandated by the Executive Order to determine whether Kaiser was warranted in implementing an affirmative action plan was all but ignored by both the district court and the court of appeals. Yet a statistical showing of gross

100. An employer cannot know with any certainty that (s)he is guilty of discrimination. This is especially true when job requirements that may be justified by business necessity are at issue, *e.g.*, Kaiser's requirements for its apprenticeship program and its craft positions. The outcome of cases in which an employer has used largely subjective criteria that have a disparate racial impact is also difficult to predict. Kaiser could not know whether it was guilty of discrimination in its hiring of the "most qualified" workers before 1969. It did know that its workforce in 1969 was only 10% black. *See* 563 F.2d at 230 (Wisdom, J., dissenting).

101. *See* note 17 and accompanying text *supra*.

102. Two company officials testified that Kaiser had not discriminated, and that Kaiser had hired the "most qualified" workers before 1969. 563 F.2d at 228 (Wisdom, J., dissenting). However, it is well-established in employment discrimination law that absence of discriminatory intent is no defense when a practice that has a discriminatory impact is not justified by business necessity. *See* *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971).

103. 563 F.2d at 224.

104. *Id.* at 224-26.

underutilization should certainly carry some weight in a reverse discrimination suit. Admittedly, demographic comparisons cannot isolate the various sources—employer and societal—that have contributed to an underrepresentation of minorities in an employer's work force.¹⁰⁵ Despite these limitations, however, the Supreme Court has recently accepted the idea that a *prima facie* case of title VII discrimination can be established by proof that minorities are underrepresented in an employer's workforce in comparison with their availability in the labor market.¹⁰⁶ Thus, even though the defenses available under title VII and the Executive Order may differ slightly,¹⁰⁷ at least the initial stages of proving discrimination are the same under both title VII and the

105. See generally Fiss, *A Theory of Fair Employment Laws*, 38 U. CHI. L. REV. 235, 265-81 (1971); Hallock, *The Numbers Game—The Use and Misuse of Statistics in Civil Rights Litigation*, 23 VILL. L. REV. 5 (1977); Note, *Employment Discrimination: Statistics and Preferences Under Title VII*, 59 VA. L. REV. 463 (1973).

Factors contributing to an underrepresentation may include: pre-1965 discrimination, for which an employer is not liable under title VII; the operation of a seniority system that may be bona fide; difference in qualifications of individual applicants in a pool of basically "qualified" applicants; social or psychological factors that may discourage minorities or women from applying for some jobs; housing patterns and transportation systems that may affect job selection. Despite these problems, such statistics are regularly used to prove and to remedy title VII discrimination. See cases cited note 75 *supra*. In all likelihood, statistics overstate an employer's actual title VII violation. Similarly, their use in formulating quota remedies ensures that quotas will remedy societal discrimination along with discrimination for which an employer is liable under title VII.

The conceptual distinction between employer discrimination and societal discrimination is unclear. If an employer locates a plant in a suburban area because it is safer, and inner-city residents therefore do not apply for jobs in a proportion that might be expected, it is difficult to characterize the resultant underrepresentation as employer or societal discrimination. If women are deterred from applying for particular industrial positions because they have been excluded from such jobs in the past and no women currently hold those positions, the discrimination may, again, be termed both employer discrimination and societal discrimination.

106. *Hazelwood School Dist. v. United States*, 433 U.S. 299, 308-09, & 309 n.14 (1977); *International Bhd. of Teamsters v. United States*, 431 U.S. at 339-43, 339-40 n.20 & 342 n.23. The minority underrepresentation approach is only one way of proving discriminatory effect and a *prima facie* case in a title VII suit. In the second method, the disparate impact approach, the exclusionary effect of a particular job requirement is shown through a comparison of the percentage of minorities who are excluded by the requirement with the percentage of whites who are excluded. *Griggs v. Duke Power Co.*, 401 U.S. 424, 429-31 (1971).

107. Under title VII, bona fide seniority systems are protected. Also, employers can offer statistical proof showing that a statistical disparity is caused by discrimination that occurred before title VII took effect in 1965. See *Hazelwood School Dist. v. United States*, 433 U.S. 299, 309 (1977). Finally, the employer can offer proof that the statistics are overbroad and do not reflect the qualified population. *Id.* at 310-13.

A contractor cannot raise the first two defenses noted above to a charge of noncompliance with the Executive Order. A contractor can use statistics showing the actual "qualified" population to formulate goals. Yet the contractor must also consider how much training (s)he is able to provide in order to make all job classifications available to minorities. 41 C.F.R. § 60-2.11(b), .23(a), (b) (1978). The obligation to provide a reasonable amount of compensatory training may go beyond what is required by title VII. Yet if the business necessity defense is construed very narrowly, employers under title VII may also have to train underqualified minorities. See *Pettway v. American Cast Iron Pipe Co.*, 494 F.2d 211, 236-40 (5th Cir. 1974) (experience prerequisite for eligibility for apprenticeship program and on-the-job training found to perpetuate effects of

Executive Order; a statistical showing of underutilization under OFCC guidelines establishes a presumptive violation of title VII. If, in the face of such an underutilization, an employer chooses to give minorities a hiring or promotional preference rather than validate existing employment criteria, or contest in court their business necessity,¹⁰⁸ the presumption that the employer has violated both title VII and the Executive Order should be even stronger. The employer, and not the court, has greater knowledge concerning whether previous employment practices were actually necessary.

Applying this to the Kaiser situation, the statistical utilization analysis conducted by Kaiser under OFCC guidelines showed that Kaiser was at least presumptively guilty of discrimination, both under title VII and under the Executive Order. Faced with these statistics, Kaiser and the predominately white Steelworkers Union implemented a program granting some minority preference, rather than contesting with the OFCC the validity of the previous requirements for craft and craft apprentice positions.¹⁰⁹ At trial, the district court had no evidence before it other than testimony of Kaiser officials to counter the presumption that Kaiser was guilty of both discrimination under title VII and under the Executive Order. This presumption should have been recognized by the court as sufficient support for the proposition that Kaiser itself was probably guilty of discrimination, and that some affirmative action was therefore justified.

In summary, strong arguments favor a court's upholding a plan

past discrimination; district court ordered to consider whether experience prerequisite could be shortened).

108. Between 1971 and 1978 OFCC guidelines and EEOC guidelines for validating scored objective criteria were substantially the same. See B. SCHLEI & P. GROSSMAN, *EMPLOYMENT DISCRIMINATION LAW* 71-73 (1976). New guidelines to be used by both OFCC and EEOC took effect on August 22, 1978. See *Uniform Guidelines on Employee Selection Procedures*, LAB. REL. REP. (BNA) 401:2231 (1977). The basic principles underlying these guidelines is that employer practices that have an adverse impact on minorities are illegal unless they are justified by business necessity.

There are no objective standards under OFCC or EEOC regulations for evaluating the legality of various nonscored objective criteria that an employer might use—for example, a prior experience or educational requirement. At the least, an employer must be able to show that the requirements are job-related, and predictive of job performance. See B. SCHLEI & P. GROSSMAN, *supra*, at 143-47. It is arguable that any requirement that excludes virtually all minorities should be justified by a higher standard of business utility than would otherwise be necessary. *Id.* at 146-47.

109. It is not clear from the record exactly what entry requirements Kaiser used for its craft positions, other than the prior experience requirement. At a different Kaiser plant, an entrance test was used until 1968, and an educational prerequisite was used until 1970. See *Parson v. Kaiser Aluminum & Chem. Corp.*, 575 F.2d 1374, 1381 (5th Cir. 1978). Any test used would have to be validated according to OFCC or EEOC guidelines.

like Kaiser's without making actual findings of title VII discrimination. Mandating such findings would only discourage employers from voluntarily taking action to remedy discrimination. Moreover, Congress in ratifying the Executive Order in 1972 affirmed that goals could be used in the absence of such findings.¹¹⁰ Previous Executive Order cases were not predicated on findings of discrimination, but on presumptions.¹¹¹ Similarly, quotas ordered pursuant to EEOC consent decrees and conciliation agreements are upheld even though such agreements contain employer disclaimers of title VII discrimination, and even though courts do not examine the facts supporting title VII liability.¹¹² Finally, the affirmative action guidelines issued by the EEOC allow an employer to utilize a remedial preference in the absence of court findings.¹¹³ A utilization analysis under OFCC guidelines, and an employer's reasonable evaluation that employment practices have an adverse affect on minorities or that such practices leave uncorrected the effects of prior discrimination, will immunize an employer from monetary liability for reverse discrimination.¹¹⁴

The court of appeals in *Weber* totally ignored congressional recognition of the Executive Order program in 1972 and thereby refused to acknowledge the independent validity of the OFCC requirements. Also, by somewhat naively accepting Kaiser's allegations that it had not discriminated, the court concluded that the Executive Order and title VII conflicted and that the former mandated a racial preference in the absence of discrimination. Proper analysis of statistics showing underutilization, and judicial notice that such statistics are used in title VII suits, would, however, have enabled the court to conclude that Kaiser was presumptively guilty of discrimination under both the Executive Order and title VII. The court could have upheld the Kaiser quota under the strength of this presumption. Such a result would have promoted voluntary compliance with title VII and would have furthered the congressionally approved objective of imposing on government contractors affirmative action requirements that may occasionally exceed what contractors have to do to comply with title VII.

110. Congress understood in 1972 that judicial findings of discrimination were not made before goals were imposed on contractors. Congress also knew that goals were being voluntarily adopted in hometown plans. See notes 49, 63, & 90 *supra*.

111. See notes 63-66 and accompanying text *supra*.

112. See General Electric Conciliation Agreement, 8 LAB. REL. REP. (BNA) 431:53, 54 (1978); Steel Industry Consent Decree I, *id.* at 431:125; Consent Decree II, *id.* at 431:147.

113. EEOC Affirmative Action Guidelines, 44 Fed. Reg. 4422 (1979).

114. *Id.* § 1608.4, 44 Fed. Reg. at 4449.

BAKKE AND THE EXECUTIVE ORDER

Some of the issues raised by the *Weber* opinion were addressed, but not resolved, in the Supreme Court's first ruling on the voluntary use of racial quotas, *Regents of the University of California v. Bakke*.¹¹⁵ In *Bakke*, a fragmented Court held that an admissions quota employed by the Medical School of the University of California at Davis violated title VI of the Civil Rights Act of 1964.¹¹⁶ Four Justices (the Stevens group) found that title VI imposes a requirement of strict racial neutrality,¹¹⁷ while five Justices (the Brennan group and Justice Powell) held that title VI affords only constitutional protection to whites claiming injury from an affirmative action plan.¹¹⁸ Despite the invalidation of the Davis quota, five Justices (the Brennan group and Justice Powell) held that race may be used as a factor in university admissions programs.¹¹⁹

Because of the peculiar split of the Court, *Bakke* is difficult to apply to *Weber*. The Court clarified only one issue—that even if title VII is applicable to action taken under the Executive Order, the language of section 703 probably codifies only equal protection guarantees when applied to affirmative action.¹²⁰ The use of a constitutional standard to judge the legality of affirmative action programs opens up possible bases for upholding voluntary affirmative action that were not considered in *Weber*. Nevertheless, it is possible that the result reached in *Weber* was correct. If a strict scrutiny test is applied to the Kaiser situation

115. 98 S. Ct. 2733 (1978).

116. 42 U.S.C. § 2000d (1976); see 98 S. Ct. at 2764 (Powell, J.); *id.* at 2813-14 (Stevens, J., concurring in part and dissenting in part) (Burger, C.J., Stewart and Rehnquist, JJ., joined in the opinion). Five Justices held the quota illegal. Justice Stevens, joined by Chief Justice Burger and Justices Rehnquist and Stewart, decided the issue on statutory grounds. Justice Powell, holding that title VI enacted constitutional principles, decided the issue on constitutional grounds.

117. *Id.* at 2814 (Stevens, J., concurring in part and dissenting in part) (Burger, C.J., Stewart and Rehnquist, JJ., joined in the opinion).

118. *Id.* at 2747 (Powell, J.); *id.* at 2774 (Brennan, White, Marshall & Blackmun, JJ., concurring in part and dissenting).

119. *Id.* at 2764 (Powell, J.); *id.* at 2766 (Brennan, White, Marshall & Blackmun, JJ., concurring in part and dissenting).

120. *Bakke* leaves unclear whether the constitutional standard is applicable to blacks also, or only to whites claiming reverse discrimination under an affirmative action plan. This issue is more critical in the title VII context, since the Supreme Court has enunciated different standards for judging discrimination against blacks under the Constitution and under title VII. Employment practices that have an adverse impact on blacks and are not justified by business necessity violate title VII although they only violate the Constitution if some discriminatory purpose is shown. *Washington v. Davis*, 426 U.S. 229 (1976).

and the government's interest in remedying discrimination is only considered compelling when there is a finding of discrimination, the Kaiser quota would be illegal even under a constitutional test.

Unfortunately, it is not clear from *Bakke* what standard of review should be applied to affirmative action programs implemented to comply with the Executive Order, much less what interests are strong enough to be recognized under the applicable constitutional test. The Stevens group never reached the constitutional issue.¹²¹ Of the five justices who did address the constitutional issue, only one, Justice Powell, applied a strict scrutiny test, concluding that the use of quotas to benefit minorities must serve a compelling purpose and must be necessary to accomplish that purpose.¹²² However, since Justice Powell's opinion was critical in affirming that a university can use a racial preference although not a quota, it arguably should be given the weight of a majority opinion, at least for affirmative action plans challenged under the various provisions of the Civil Rights Act.

In applying the strict scrutiny test, Justice Powell inferred the government's interest in remedying discrimination was not compelling in the absence of judicial or administrative findings of discrimination or a remedial scheme authorized by Congress.¹²³ Justice Powell specifically rejected the goal of remedying societal discrimination as a compelling purpose.¹²⁴ Two objectives are generally suggested as being served by the Executive Order. One is the government's interest in ensuring that all groups in society share equally in the employment opportunities created and supported by government spending. In addition, the government has an interest in remedying the effects of past employment-related discrimination that can be presumed to exist from severe under-representations of minorities in an employer's workforce.¹²⁵ Given

121. 98 S. Ct. at 2814 (Stevens, J., concurring in part and dissenting in part) (Burger, C.J., Stewart and Rehnquist, JJ., joined in the opinion).

122. *Id.* at 2749.

123. Justice Powell noted that classifications favoring victimized groups have never been approved absent a judicial, legislative, or administrative finding of a constitutional or statutory violation. *Id.* at 2757-58. He recognized the validity of congressionally authorized administrative actions, and legislation passed by Congress pursuant to its powers under the thirteenth and fourteenth amendments. *Id.* at 2755 n.41. However, he emphasized the need for "legislatively-determined criteria" and stressed that the classification should be responsive to "identified discrimination." *Id.* at 2759.

Arguably, congressional approval of the Executive Order makes the Executive Order program congressionally approved administrative action. Congressional authority to approve broad racial classifications to remedy general employment discrimination can be found in U.S. CONST. amend. XIII, § 2, and *id.* amend. XIV, § 5.

124. 98 S. Ct. at 2756-58.

125. See 118 CONG. REC. 1664 (1972) (remarks of Sen. Javits) (recognizing both government's

Justice Powell's analysis, whether or not these purposes are considered compelling may depend on whether the Executive Order has been ratified by Congress.

Congressional ratification in 1972, the consonance of the purposes served by both the Executive Order and title VII,¹²⁶ and the direct control Congress exercises over the OFCC are all factors that give the Executive Order program a status similar to that of a program enacted directly by Congress and provide a basis for arguing its validity under *Bakke*. At the time of ratification in 1972, Congress discussed and implicitly affirmed the use of goals and timetables and remedial racial preferences. It also debated and implicitly accepted the validity of using government contracts to enforce remedial action that went beyond title VII and that would ensure that all *groups* within American society share in the benefits resulting from government spending. Finally, Congress recognized that requirements imposed under the Executive Order do not rest on determinations of past discrimination.¹²⁷ Given that the 1972 Congress apparently fully understood the operation of the Executive Order program, and that present and future Congresses can restrict the operation of the OFCC in any way, it seems the contract compliance program should be considered as remedial legislation. Accordingly, it should not be necessary that specific determinations of discrimination be made before an employer can implement an affirmative action program involving some racial preference. Similarly, that the Executive Order program is largely self-enforcing should not be taken to indicate that the discrimination it remedies is not identifiable or is merely societal discrimination.

A compelling government interest does not alone justify the use of racial classifications. The classification must also be necessary in light of the purpose to be achieved. Assuming, in light of the implicit congressional authorization of the use of remedial preferences by government contractors, that employers are allowed to use some degree of

ability to promote full utilization of minority employees and government's power to correct discrimination); *id.* at 4918 (remarks of Sen. Javits) (noting that government can affirmatively encourage nondiscrimination and full utilization of minority group employees and women through its contracting power). These remarks were made during the debates in 1972 over the two amendments that would have restricted the Executive Order program. See notes 80 & 88 *supra*. See also *EEOC v. American Tel. & Tel. Co.*, 556 F.2d at 175, 179 (government has interest in having all groups "fairly represented" in employment).

126. The Supreme Court has recognized that a primary objective of title VII is prophylactic: to remove barriers that have operated to favor white male employees over other employees. *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 417-18 (1975); *Griggs v. Duke Power Co.*, 401 U.S. 424, 429-30 (1971).

127. See notes 80-90 and accompanying text *supra*.

racial preference to comply with the Executive Order, the issue is whether that preference can take the form of a goal or quota as used by Kaiser.

In *Bakke*, the Brennan group upheld the use of quotas to remedy societal discrimination.¹²⁸ Justice Powell, though, found that in light of its objective of maintaining a diverse student body, Davis could only make race "a factor" in its admissions program.¹²⁹ Race could only be used as one factor among many because the particular goal that Justice Powell recognized as compelling in *Bakke*—attaining a diverse student body—is necessarily achieved through use of numerous factors. In contrast to the goal of achieving diversity, the Executive Order focuses particularly on minority group status and achievement. Its goal is to upgrade the status of minority and women workers by forcing institutional changes in hiring and promotion that will both remedy the effects of past discrimination and prevent future discrimination. In some contexts, most notably the area of professional employment, these purposes may perhaps be served through a decisional process that factors in race among other attributes. But such a system is unrealistic in the typical industrial employment context in which employment decisions are not made with regard to a number of individual factors. For example, in *Weber*, seniority was the only criterion used to select among the applicants, all of whom were basically qualified. As seniority is allowed as a dominant factor in selection for industrial opportunities, race must also be considered a critical factor. The explicit consideration of race is necessary to remedy the employment discrimination evidenced by statistics showing gross minority underutilization. That alternate means, such as recruitment, would be unsuccessful is evidenced by the situation at Kaiser's plant in 1974. Minorities held 5 of 273 craft positions. The failure of less "drastic" ways of ensuring non-discrimination and promoting job mobility in the skilled trades has been well-documented.¹³⁰ Arguably, therefore, there were no means of upgrading the skills of minorities and guaranteeing that the effects of past discrimination would not be carried into the future other than by

128. 98 S. Ct. at 2789-93 (Brennan, White, Marshall & Blackmun, JJ., concurring in part and dissenting).

129. *Id.* at 2762-63. As the Brennan group noted, there is no difference between allowing a racial preference and allowing a quota, other than that the public might find the former more palatable since it obscures the actual weight given to race. However, both result in some exclusion of white candidates. *Id.* at 2793-94 (Brennan, White, Marshall & Blackmun, JJ., concurring in part and dissenting).

130. See generally W. GOULD, *BLACK WORKERS IN WHITE UNIONS: JOB DISCRIMINATION IN THE UNITED STATES* 281-362 (1977).

targeting new training opportunities to minorities and women. Such targeting can best be achieved through the use of goals or quotas.

The previous analysis illustrates that *Bakke* does not foreclose the possibility of upholding a quota such as Kaiser's. However, if the interests served by the Executive Order are not considered "compelling" or if quotas are rejected as unnecessary, then under Justice Powell's analysis a quota could only be implemented in response to prior findings of discrimination.¹³¹ This result is actually narrower than that reached in *Weber*. Yet, Justice Powell also intimated that quotas might be permissible in circumstances broader than those suggested in *Weber*. For example, Justice Powell cited with apparent approval the construction industry cases, thus implying that prevailing OFCC standards rather than title VII standards may be used to evaluate discrimination, and that administrative findings of third-party discrimination may warrant quota relief.¹³² If these possibilities were further developed, perhaps the OFCC could make industry-wide findings of discrimination in order to legalize quotas in major industries.

CONCLUSION

It is important that the concept of identifiable discrimination articulated by Justice Powell in *Bakke*¹³³ not be interpreted to mean "actual employer discrimination," as was demanded by the *Weber* court.¹³⁴ The differentiation between employer and societal discrimination presents obvious evidentiary problems since no party before the court in an affirmative action case has an interest in proving employer discrimination. Moreover, the use of statistics in both the proof and remedial stages of litigation under title VII and in the Executive Order program makes it extremely difficult to separate the effects of societal and employer discrimination. Given these difficulties, and the implicit recognition of the importance of societal discrimination that is embodied in the use of quotas in *any* circumstance, it is doubtful that the constitutionality of racial classifications should depend on the distinction.

Rather than being limited to findings of employer discrimination,

131. 98 S. Ct. at 2754-59.

132. *Id.* at 2754 n.40.

133. *Id.* at 2754-59.

134. 563 F.2d at 224-25.

the concept of identifiable discrimination should be broadened in affirmative action litigation to include "presumptive" discrimination. Although the Supreme Court has rejected the idea that disparate impact or minority underrepresentation alone makes out a constitutional¹³⁵ or statutory violation,¹³⁶ it has accepted the fact that a statistical underrepresentation creates a presumption of discrimination that shifts to the employer the burden of proving nondiscrimination.¹³⁷ When statistics showing underrepresentation are used in accordance with a legislatively approved remedial scheme such as the Executive Order program, they should be weighed heavily by the courts in determining whether an affirmative action program is justified by employment discrimination. The idea that a court can recognize the existence of probable discrimination without making actual findings to that effect is supported by early Executive Order decisions, by judicial acceptance of consent decrees under title VII, and by congressional approval of the Executive Order program in 1972.

Beyond the broad statutory and constitutional issues *Weber* raises, the case demonstrates the reality of "progress" in "equal employment opportunity" for minorities in this country. After ten years of enjoying the legal rights to equal employment under the Civil Rights Act of 1964, minorities, who comprised thirty-nine percent of the area labor force, held only two percent of the craft positions at Kaiser's plant. Such statistics demonstrate the continuing effects of employment discrimination, and that legal rights alone may result in little measurable economic progress for minorities. As was noted in an early Executive Order decision, "it is fundamental that civil rights, without economic rights, are mere shadows."¹³⁸ In order to remedy past and continuing discrimination, and in order to guarantee some measure of economic progress to minorities and women, training opportunities must be targeted. Arguably, targeting cannot be achieved without the use of quotas. At the least, modest entry quotas should be permitted¹³⁹ for

135. *Washington v. Davis*, 426 U.S. 229 (1976).

136. Disparate impact or extreme underrepresentation can constitute a statutory violation but only if the employer cannot successfully rebut the inference of discrimination. *Hazelwood School Dist. v. United States*, 433 U.S. 299, 311-13 (1977); *Dothard v. Rawlinson*, 433 U.S. 321, 339-40 (1977).

137. See note 106 *supra*.

138. *Contractors Ass'n v. Secretary of Labor*, 311 F. Supp. 1002, 1010 (E.D.Pa. 1970).

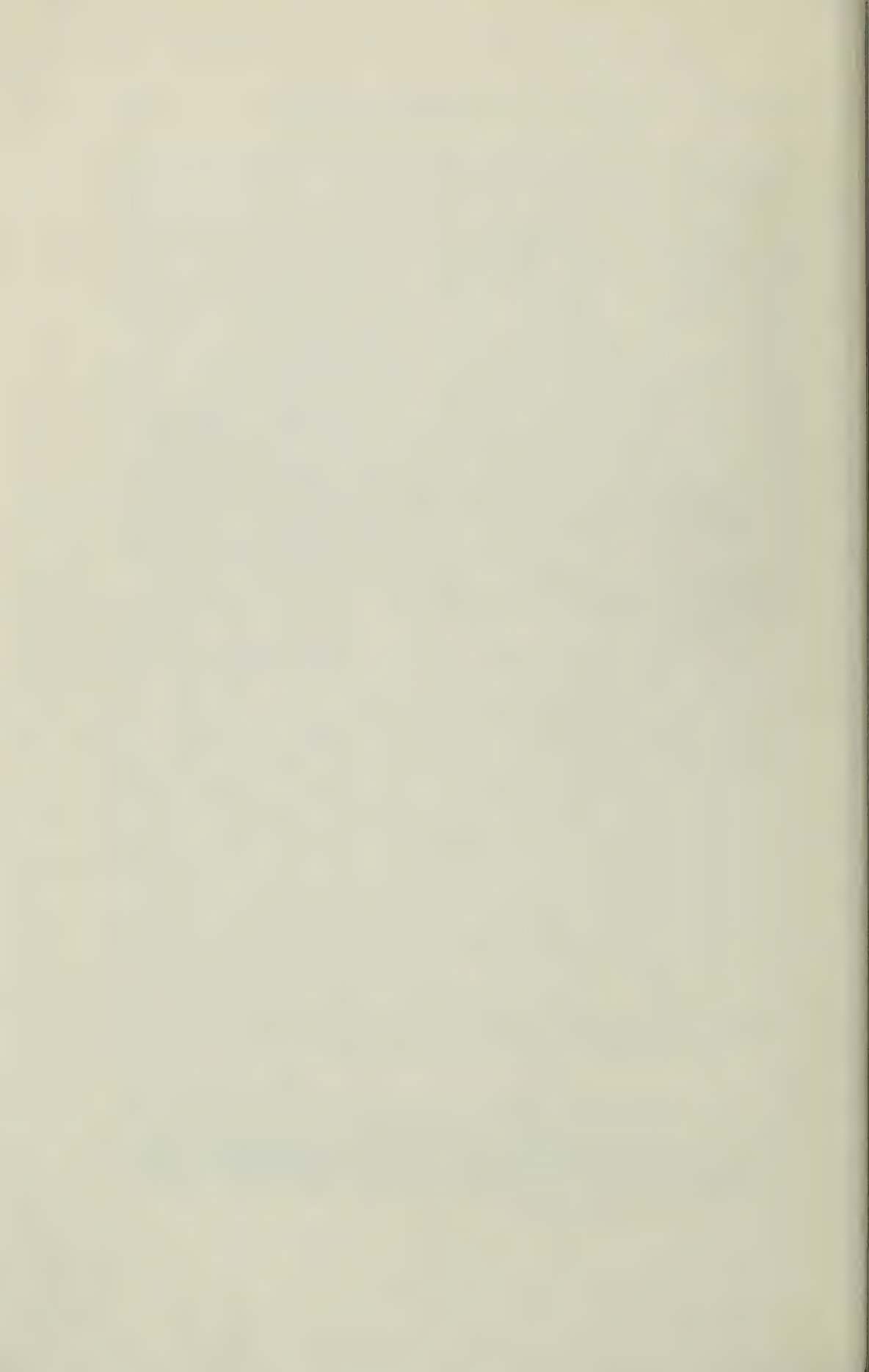
139. The 50% quota for Kaiser's program is misleading. In the first year the training program admitted 7 blacks, and one black craftsman was hired from outside the plant. The same year, 6 whites were admitted into the training program, and 21 whites were hired as craftsmen from

totally new training opportunities, with respect to which majority workers have no existing rights or expectations.

Major industrial employers such as Kaiser are well-situated to remedy both their own discrimination and other employment-related discrimination that affects opportunities within their industries. Judicial insistence on findings of discrimination either prior to or subsequent to the implementation of a quota will probably halt all voluntary affirmative action programs by employers like Kaiser. Conditioning preferential treatment on industry-wide administrative findings of discrimination, and defining discrimination by OFCC standards, is preferable to requiring judicial findings of title VII violations. Nonetheless, even this option would significantly impede progress toward equal employment goals by making all affirmative action dependent on administrative proceedings. Remedial action would thus slow to a snail's pace. This result is legally unnecessary, in light of the possibility of affirming the legality of the Executive Order program and its system of self-enforcement, and recognizing that in the vast majority of cases title VII and the Executive Order are complementary, and not contradictory.

KAREN ANN SINDELAR

outside the plant. Kaiser's program would have ensured an increase of approximately 2.5% minority craftsmen yearly. Petition for Writ of Certiorari on behalf of the United States and Equal Employment Opportunity Commission at 3-5.



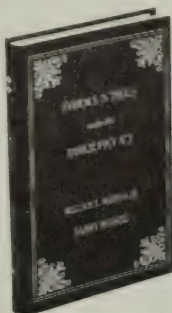
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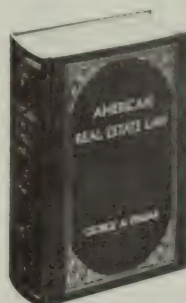
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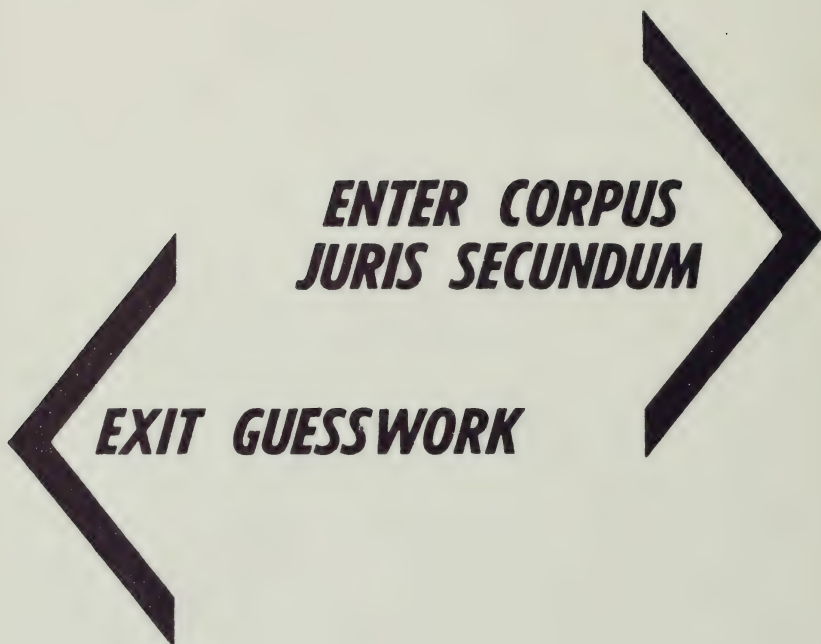
NORTH CAROLINA LAW REVIEW



THE RULE AGAINST PERPETUITIES IN NORTH CAROLINA

Ronald C. Link

SURVEY OF DEVELOPMENTS IN NORTH CAROLINA LAW, 1978



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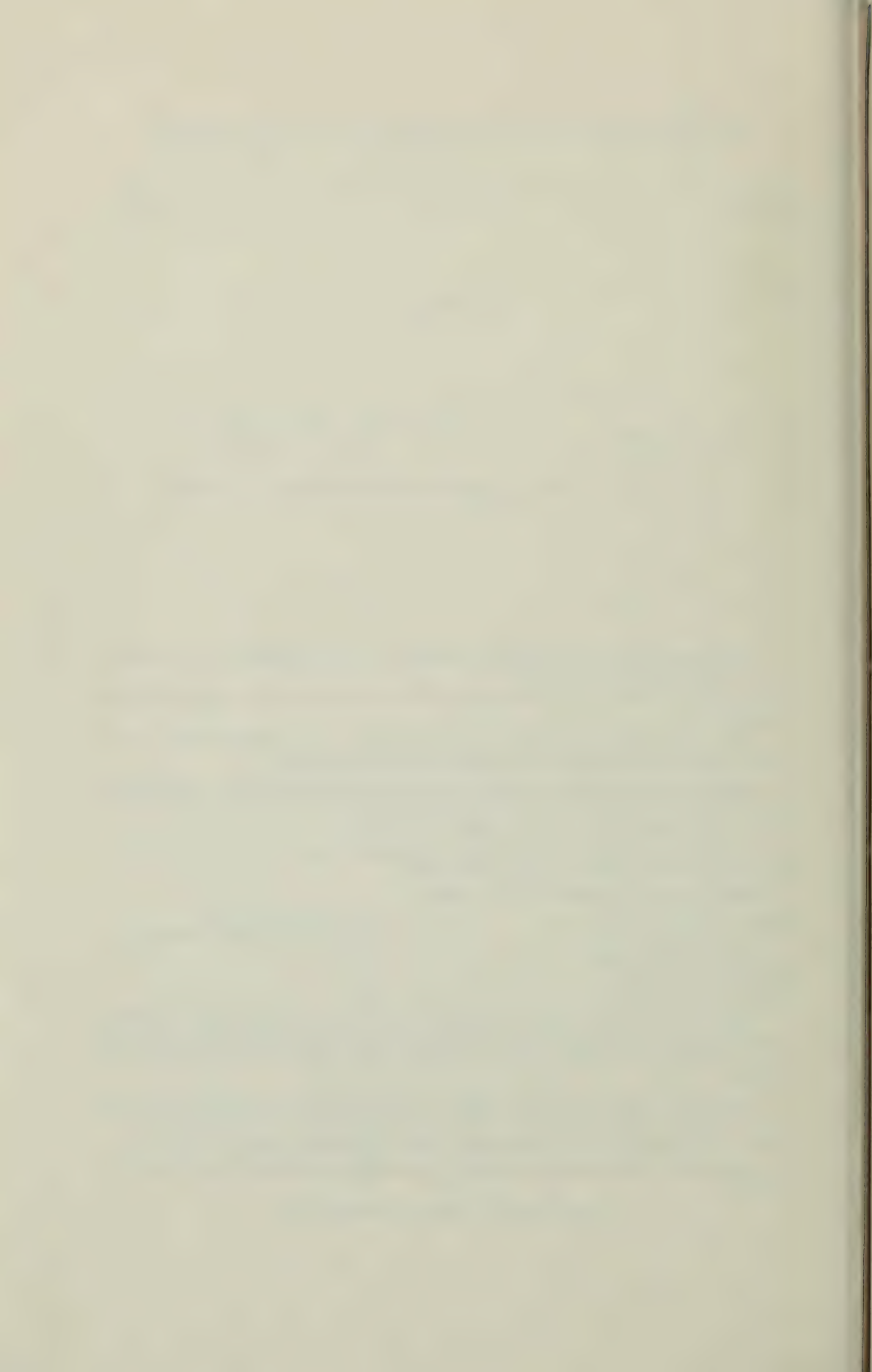
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THE RULE AGAINST PERPETUITIES IN NORTH CAROLINA

RONALD C. LINK†

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The world of estates and future interests in North Carolina is a fascinating one (at least to collectors of incunabula). Here is found almost the full panoply of common law freehold estates: the fee simple absolute; the defeasible fees including the fee simple determinable, the fee simple subject to condition subsequent, and the fee simple subject to executory limitation;¹ and the life estate. Although our statutes convert the fee tail into a fee simple,² one must understand the feudal niceties of the fee tail in order to know when the statutes will operate. Fortunately, North Carolina has never recognized the fee simple conditional,³ a medieval estate eliminated in England in 1285;⁴ the distinc-

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1. See McCall, *Estates on Condition and on Special Limitation in North Carolina*, 19 N.C.L. REV. 334 (1941).

2. N.C. GEN. STAT. § 41-1 (1976): "Every person seized of an estate in tail shall be deemed to be seized of the same in fee simple."

3. Prior to 1285 a conveyance "to A and the heirs of his body" created in A a fee simple conditional upon the birth of issue. If, after the birth of issue, A failed to convey the estate, it passed on his death to his issue in fee simple conditional, with the same consequences. J. CRIBBET, *PRINCIPLES OF THE LAW OF PROPERTY* 46 (2d ed. 1975).

4. Statute De Donis Conditionalibus, 13 Edw. 1, c. 1 (1285).

tion of sanctioning that estate is reserved for our sister state to the south.⁵

The feudal conveyancer would also find his full armamentarium of future interests, reversions, possibilities of reversion and powers of termination (rights of entry) for the grantor, remainders (indefeasibly vested, vested subject to total divestiture, vested subject to partial divestiture and contingent), and executory interests (springing and shifting) for the grantee. Were Lord Coke to emerge, H. G. Wells-like, from a time machine into a twentieth-century Tar Heel State's court, he would not be unfamiliar with many of the doctrines and issues associated with our future interests. Worthier Title may have been abolished,⁶ but Destructibility of Contingent Remainders lurks in the cases.⁷ The Rule in *Shelley's Case* is alive and well and living in Raleigh,⁸ and the Rule in *Wild's Case*, dating from 1549, is still with us.⁹ Various restrictive common law rules have led to meliorating North Carolina statutes furthering the transferability of future inter-

5. J. L. SIMES & A. SMITH, *THE LAW OF FUTURE INTERESTS* § 62 (2d ed. 1956); NOTE, *The Fee Simple Conditional in South Carolina*, 18 S.C.L. REV. 476 (1965).

6. See N.C. GEN. STAT. § 264-1-2 (1976). Compare *id.* with LINK, *The Rule in Wild's Case in North Carolina*, 35 N.C.L. REV. 751, 624 (1977). One question not addressed in this article is whether the abolition applies to instruments other than wills (chapter 264 deals with decedent's estates) and, if so, whether it applies retroactively.

The statutory presumption that "heir" means "child(ren)" tends to limit the operation of the doctrine. See N.C. GEN. STAT. § 43-1 (1976); N.C. GEN. STAT. § 43-1.1 (1976) ("next of kin" presumed to mean "those persons who would take under the law of intestate succession").

On Worthier Title generally, see 41 N.C.L. REV. 317 (1967); 34 N.C.L. REV. 40 (1955).

7. Dictum in *Bianchard v. Ward*, 244 N.C. 642, 646-49, 92 S.E.2d 776, 791 (1956), suggests that destructibility may still arise in North Carolina via the doctrine of merger. See *Fourth Annual Survey of North Carolina Case Law*, 35 N.C.L. REV. 177, 257 (1977). See generally WADL, *The Destructibility of Contingent Remainders in North Carolina*, 36 N.C.L. REV. 67 (1967).

There is a kind of statutory destructibility in North Carolina. The grantor of a deed or settlor of a trust creating a contingent future interest in some person not *in esse* or not determined until the happening of some future event may revoke the grant of the interest at any time prior to the happening of the contingency vesting the future interest. N.C. GEN. STAT. §§ 24-1, -2, (1976); *id.* §§ 43-11, -13, -15 generally, allowing sale or mortgage of property subject to contingent remainders, with proceeds of sale to be held for ascertainment of ultimate remaindermen.

8. E.g., *Starnes v. Hill*, 102 N.C. 1, 10 S.E. 103 (1893); N.C. GEN. STAT. § 24-1.1 (1976). The statute provides that in construing conveyances the court shall give effect to the intention of the parties, but has an express proviso that the section shall not prevent the application of the Rule in *Shelley's Case*.

The Rule in *Shelley's Case* has ever been extended to personal property. *Rege v. Lively*, 265 N.C. 204, 143 S.E.2d 65 (1965), noted in 36 W. VA. L. REV. 104 (1965). On *Shelley's Case* generally, see BLACK, *The Rule in Shelley's Case in North Carolina*, 20 N.C.L. REV. 49 (1944); WEBSTER, *A Re-look North Carolina Can Do Without—The Rule in Shelley's Case*, 45 N.C.L. REV. 3 (1966).

9. LINK, *supra* note 1, at 615-21.

ests,¹⁰ sanctioning the creation of future interests in personalty by inter vivos instrument,¹¹ and establishing a constructional preference for definite failure of issue.¹² The Statute of Uses, in a form recognizable by Henry VIII, lies entombed in the General Statutes.¹³

Many of the rules, doctrines and issues just listed are of somewhat limited current significance. Destructibility of Contingent Remainders, for example, customarily is restricted to legal (not equitable) remainders (not executory interests) in real property (not personalty); its potential scope is therefore limited. Even those old rules, such as the Rules in Shelley's Case¹⁴ and Wild's Case,¹⁵ which are now applied to equitable interests as well as legal ones and to personalty as well as realty, apply only if the creator uses certain fatal language not ordinarily found in modern instruments. (At least one hopes that lawyers avoid such pregnant language as "to *A* and his children" (invoking the Rule in Wild's Case) or such notorious phrases as "to *A* for life, remainder to his heirs" (invoking the Rule in Shelley's Case). Laymen may blunder into such usages, but there are limits to the preventive scope of the law.¹⁶)

On the other hand, the Rule Against Perpetuities, while derived from centuries-old principles, remains a vital concept. It applies to legal and equitable interests, to real property and personal property, to family dispositions and, perhaps unexpectedly, to some commercial transactions (for example, options, leases and condominiums). Further, the kinds of gratuitous dispositions to which the Rule Against Perpetuities applies include two of the most common dispositive tools in modern estate planning: class gifts and powers of appointment. For various reasons, it is often advisable for the draftsman of a will or trust disposing of a modest or large estate to create class gifts¹⁷ and powers

10. N.C. GEN. STAT. §§ 29-2 (inheritability), 31-40 (devisability), 39-6.3 (alienability) (1976).

11. *Id.* § 39-6.2 (overturning rule of *Speight v. Speight*, 208 N.C. 132, 179 S.E. 461 (1935), noted in 14 N.C.L. REV. 196 (1935), which held that future interests in personal property, which may be created by will, could not also be created by deed).

12. *Id.* § 41-4.

13. *Id.* § 41-7.

14. For the Rule in Shelley's Case to apply to equitable interests, both the preceding freehold estate to the ancestor (*e.g.*, the life estate to *A*) and the remainder to the ancestor's heirs or bodily heirs must be equitable. If one is legal and the other equitable, the Rule does not apply. If both are legal, of course, the Rule applies. See Webster, *supra* note 8, at 14-15.

15. See Link, *supra* note 6, at 783-85.

16. Because laymen persist in drawing their own wills, it has been suggested that, rather than ignore the problem, the bar promulgate an official will form and instructions for using it. JUSTICE (SOCIETY) HOME-MADE WILLS (1971).

17. Except for very simple estates, the testator or settlor almost inevitably will want to create interests in unborn or unascertained beneficiaries, requiring the use of a general class designation.

of appointment.¹⁸ The Rule applies to both, sometimes in a surprising¹⁹ or unexpected²⁰ fashion. The Rule Against Perpetuities, then, is not a cubbyhole for antiquarians; it is a strong, wide-ranging creature based on enduring policies. Some general knowledge of the Rule is important to almost every lawyer, to enable him to recognize perpetuities problems, and a working knowledge of the intricacies of the Rule is essential to the probate lawyer.

In view of the range and depth of available analyses of North Carolina estates and future interests issues,²¹ it is surprising that the Rule Against Perpetuities has not been the subject of comprehensive scrutiny.²² Perhaps the reputation of the Rule as "a technicality-ridden legal nightmare"²³ or as a "trap and snare for the unwary"²⁴ has discouraged inquiry. Despite this daunting prospect, the time seems right for a look at the North Carolina Rule. While the last few decades have witnessed widespread debate and occasional reform of "the Rule"²⁵ in other states,²⁶ the flow of North Carolina cases on perpetu-

18. Special powers preserve flexibility over the shares of the second generation of takers under a will or trust: "To regulate events in 1980 the judgment of a mediocre mind on the spot is incomparably preferable to the guess in 1960 of the greatest man who ever lived." W.B. LEACH & J. LOGAN, *CASES AND TEXT ON FUTURE INTERESTS AND ESTATE PLANNING* 241-42 (1961).

General testamentary powers often accompany gifts of life estates to surviving spouses in order to qualify the share for the marital deduction while limiting the spouse's control over the property.

19. For example, the "all-or-nothing rule" of *Leake v. Robinson*, 35 Eng. Rep. 979 (Ch. 1817), that a class gift is totally bad if the gift to any potential class member can vest too remotely. *See* section III. *infra*.

20. For example, the validity of interests created by exercise of a general testamentary power is determined by reading the appointment back into the instrument creating the power, and the period of perpetuities runs from the date the power is created, not the date the appointment is made. *See* section IV. *infra*.

21. As examples, consider the articles cited in notes 1, 6, 7 & 8 *supra*.

22. The Rule is treated in 1 S. MORDECAI, *LAW LECTURES* 588-89, 595-96 (2d ed. 1916); 2 *id.* 1158, 1162, 1281-82; 7 STRONG'S NORTH CAROLINA INDEX 3D *Wills* § 41 (1978); and 2 N. WIGGINS, *WILLS AND ADMINISTRATION OF ESTATES IN NORTH CAROLINA* § 287 (1964).

There is no shortage of outstanding general works. The classic is, of course, J.C. GRAY, *THE RULE AGAINST PERPETUITIES* (4th ed. 1942). Valuable treatises include 6 AMERICAN LAW OF PROPERTY pt. 24 (A.J. Casner ed. 1952) (authored by Professor Leach) [hereinafter cited as ALP]; T. BERGIN & P. HASKELL, *PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS* 183-229 (1966); 5 R. POWELL, *THE LAW OF REAL PROPERTY* chs. 71-73 (rev. ed. P. Rohan 1977); 3 L. SIMES & A. SMITH, *supra* note 5, ch. 39. *See also* RESTATEMENT OF PROPERTY chs. 26-28 (1944) (the Reporter was Professor Powell). Professor Leach authored a number of law review articles on the subject, to which this writer's debt will be apparent. They include Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638 (1938); *Perpetuities: The Nutshell Revisited*, 78 HARV. L. REV. 973 (1965); and *The Rule Against Perpetuities and Gifts to Classes*, 51 HARV. L. REV. 1329 (1938).

23. Leach, *Perpetuities Legislation, Massachusetts Style*, 67 HARV. L. REV. 1349 (1954).

24. The source of this epithet lies buried in the author's subconscious.

25. Some indication of the impact of the Rule Against Perpetuities is given by its common denomination simply as "the Rule."

26. The statutes are collected in 5 R. POWELL, *supra* note 22, ¶¶ 807A-827.

ities questions continues unabated. The purpose of this article is to examine the Rule Against Perpetuities as it is applied in North Carolina, with particular emphasis on those aspects of the Rule of greatest importance to the modern estate planner and draftsman. For the estate planner, the Rule's application to class gifts, to powers of appointment, and to the duration of trusts is of primary concern. For the draftsman, the single most important problem is one of prevision—anticipating when the Rule may be involved—so the article will stress some of the unexpected applications of the Rule, particularly those involving commercial transactions. Developing case law suggests that an attorney may be negligent in drafting an instrument containing perpetuities errors,²⁷ so these matters are not purely of academic interest.

In delineating the North Carolina Rule, this article will compare its application to that in other states, will ask whether our courts have applied the Rule correctly, and will inquire whether reform is advisable, and, if so, which form it should take.

I. EVOLUTION OF THE RULE

The classic statement of the Rule Against Perpetuities is by Gray: No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.²⁸

Leach remarks that "Gray's formulation would be more realistic if it were preceded by the words *Generally speaking* and if the word *vest* were put in quotation marks."²⁹

Of course, the Rule did not spring forth in this form from the brow of the first judge to decide a perpetuities case. Rather, the Rule evolved in a classic common law fashion—on a case-by-case basis over the course of nearly two centuries—until it was reduced to the Holy Writ of Gray's codification. Because the evolution of the Rule in North Carolina followed roughly the same path as the English cases, the development of the Rule in England will be described briefly.

A. *Evolution of the Rule in England*

It has been postulated that developments in real property law have

27. See section VI. *infra*.

28. J.C. GRAY, *supra* note 22, § 201.

29. Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 639 (1938).

followed a Hegelian path of thesis, antithesis, and synthesis.³⁰ Conventional analyses of the Rule Against Perpetuities treat it as the product of a struggle between the attempts of past generations to tie up land and the desires of present generations freely to dispose of it.³¹ Most major developments of English land law can be analyzed in terms of a struggle over free alienability of real property.³² The progression may be represented schematically as follows:³³

Thesis (to restrain alienability)

1. Conveyance "to *A* and his heirs."
Result: This created an interest in *A*'s heirs that could not be defeated by *A*'s conveyance.
2. Conveyance "to *A* and his bodily heirs."
Result: This created an interest in *A*'s descendants that was certain to pass to them at his death.
3. Statute De Donis Conditionalibus, 1285.³⁵
Result: Fee tail. This statute gave effect to the fee tail. *A* could not bar his descendants.

Antithesis (to further alienability)

- 1a. *D'Arundel's Case*, 1225.³⁴
Result: The words "and his heirs" were interpreted as words of limitation, limiting or describing *A*'s estate. *A* took in fee simple absolute, free from any obligation to his heirs.
- 2a. Thirteenth Century Cases.
Result: Fee simple conditional. The conveyance was interpreted as creating a fee simple conditional in *A*; if the condition of birth of issue were met, *A* had the power to convey absolute ownership.
- 3a. *Taltarum's Case*,³⁶ 1472.
Result: Common recovery. By going through a largely fictional lawsuit, the common recovery, *A*, the tenant in tail in possession, could "dock the entail" and convert his estate into a fee simple absolute.

At this point, circa the sixteenth century, the number of alternative moves and countermoves multiplied and the story became more complex.³⁷ On the side of restraining alienation were variations on the ba-

30. E. RABIN, *FUNDAMENTALS OF MODERN REAL PROPERTY LAW* 223 (1974):

Hegel . . . developed a theory of thesis, antithesis, and synthesis. Each development (thesis) in human affairs developed opposition (antithesis), and from the clash of these opposing forces came a new development (synthesis). Whether this is true at all times in all places and in all contexts I do not know, but it certainly has been true of the development of property law institutions.

31. *E.g.*, RESTATEMENT OF PROPERTY, Introductory Note, div. 4, pt. 1, at 2123-29 (1944).

32. *E.g.*, E. RABIN, *supra* note 30.

33. See generally 5 R. POWELL, *supra* note 22, ¶ 759[1]; E. RABIN, *supra* note 30; RESTATEMENT OF PROPERTY, *supra* note 31.

34. Bracton's Notebook, Case 1054 (1225).

35. 13 Edw. 1, c. 1 (1285).

36. Y.B. Mich. 12 Edw. 4, 19, pl. 25 (1472).

37. Perpetuities aspects aside, the next move by those who would entail land was the strict settlement, an ingenious device for tying up family estates. See W.B. LEACH & J. LOGAN, *supra* note 18, at 102-03. The ultimate fate of the legal fee tail in England was abolition by the reform legislation of 1925.

sic fee tail. One device to restrain alienation was by conveyance of land in fee tail with the added condition that any attempt to dock the entail (as by common recovery) would terminate the estate of the person attempting disentanglement. These conditions were struck down as repugnant to the fee tail and were often described as "perpetuities," since, if given effect, the fee tail might last forever. Thus, the loathed "perpetuity" first arose in the context of a present, inalienable estate in land.³⁸

At about the same time, English conveyancers began to tie up land by using future interests instead of the present estate in fee tail. Contingent remainders were used first, and the armamentarium was expanded by the Statute of Uses in 1535³⁹ to include executory interests. Contingent interests in unborn or unascertained remaindermen restrained alienability since, obviously, the property could not be sold if the owners of some outstanding interests were unborn or unascertained.⁴⁰ The reaction to this technique was, for remainders, the doctrine of Destructibility of Contingent Remainders, which furthered alienability by allowing for destruction of contingent remainders by natural or artificial means.⁴¹ It was supposed that executory interests were also subject to destructibility, but in 1620 the case of *Pells v. Brown*⁴² held that they could not be destroyed, despite a dissenting view that the holding would lead to a "mischievous kind of perpetuity."⁴³ Gray⁴⁴ and others⁴⁵ believe that *Pells v. Brown* made the

38. Another attempt to avoid docking of the entail involved the creation of an equivalent of the fee tail in a long term of years. The courts struck down this device by holding that a term of years could not be entailed and that the attempt to do so gave the grantee the entire term. On these fee tail variations, see generally 5 R. POWELL, *supra* note 22, ¶ 759[2]; RESTATEMENT OF PROPERTY, *supra* note 31, at 2126-27; 3 L. SIMES & A. SMITH, *supra* note 5, § 1212.

On the history of the Rule Against Perpetuities, see generally 5 R. POWELL, *supra* note 22, ¶¶ 759-760; RESTATEMENT OF PROPERTY, *supra* note 31, at 2125-29; 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1201-1202, 1211-1213; Bostick, *The Tennessee Rule Against Perpetuities: A Proposal for Statutory Reform*, 27 VAND. L. REV. 1153, 1154-59 (1974); Schuyler, *The Statute Concerning Perpetuities*, 65 NW. U.L. REV. 3, 4-5 (1970).

39. 27 Hen. 8, c. 10 (1535). See generally C. MOYNIHAN, INTRODUCTION TO THE LAW OF REAL PROPERTY 173-215 (rev. ed. 1962).

40. Even if the remaindermen were ascertained, it is argued that the existence of a remainder contingent upon an event (for example, "to A for life, and if UNC wins the NCAA basketball championship, to B and his heirs, and if UNC does not win the NCAA basketball championship, to C and his heirs") restrains alienability because it is unlikely that B and C will get together and agree on the terms of a sale. Because the event is uncertain, B and C are not likely to agree on the valuation of their respective interests. L. SIMES, PUBLIC POLICY AND THE DEAD HAND 36-38 (1955).

41. See generally 1 L. SIMES & A. SMITH, *supra* note 5, §§ 193-209.

42. 79 Eng. Rep. 504 (K.B. 1620).

43. 79 Eng. Rep. at 506 (Doderidge, J., dissenting).

44. J.C. GRAY, *supra* note 22, § 121.7.

45. E.g., Schuyler, *supra* note 38, at 5.

Rule Against Perpetuities inevitable: something had to be invented to control indestructible executory interests.

That invention took place in six landmark cases,⁴⁶ beginning with the *Duke of Norfolk's Case*⁴⁷ in 1682, ranging through *Thellusson v. Woodford*⁴⁸ in 1805, and ending with *Cadell v. Palmer*⁴⁹ in 1833. The *Duke of Norfolk's Case* is the most important and will be summarized here. Simply stated, an estate for 200 years⁵⁰ was given to Henry and his issue, but if Thomas should die without issue during the life of Henry, to Charles. At the time of the decision, it was not clear what a perpetuity was or what period, if any, was permissible for a perpetuity. The only prior cases on the notion were those holding an unbarrable present estate tail invalid as tending to a perpetuity.⁵¹ When future interests were concerned, the law was unclear.⁵²

The issue that divided the judges in this case was not whether perpetuities should be allowed, but what perpetuities were, or more exactly, whether this case presented a perpetuity. On one side it could be argued that the contingency upon which the disposition of the property turned was certain to happen within a short period of time, so it was foolish to refer to the gift as a perpetuity. On the other side, it might be argued that the type of interest created should be found destructible; otherwise the all important preference for free alienability would be compromised. This second argument was the traditional approach to perpetuities and convinced the common law

46. The cases are discussed in 5 R. POWELL, *supra* note 22, ¶ 760[2].

47. 22 Eng. Rep. 931 (Ch. 1682).

48. 32 Eng. Rep. 1030 (Ch. 1805).

49. 6 Eng. Rep. 956 (H.L. 1833).

50. With three exceptions, all of the perpetuities cases preceding the *Duke of Norfolk's Case* involved estates for years. J.C. GRAY, *supra* note 22, §§ 160, 161. The reasons for this conveyancing usage are described in Haskins, *Extending the Grasp of the Dead Hand: Reflections on the Origins of the Rule Against Perpetuities*, 126 U. PA. L. REV. 19, 34-35 (1977).

51. See text accompanying note 39 *supra*.

52. To Lord Nottingham in the *Duke of Norfolk's Case*, a perpetuity was an unbarrable entail:

A Perpetuity is the Settlement of an Estate or an Interest in Tail, with such Remainders expectant upon it, as are in no Sort in the Power of the Tenant in Tail in Possession, to dock by any Recovery or Assignment, but such Remainders must continue as perpetual Clogs upon the Estate; such do fight against God, for they pretend to such a Stability in human Affairs, as the Nature of them admits not of, and they are against the Reason and the Policy of the Law, and therefore not to be endured.

But on the other Side, future Interests, springing Trusts, or Trusts executory, Remainders that are to emerge and arise upon Contingencies, are quite out of the Rules and Reasons of Perpetuities, nay, out of the Reason upon which the Policy of the Law is founded in those Cases, especially, if they be not of remote or long Consideration: but such as by a natural and easy Interpretation will speedily wear out, and so Things come to their right Chancel again.

22 Eng. Rep. at 949-50.

judges Lord Nottingham consulted. The first argument, however, convinced the Chancellor, and was the one that has become the basis for the modern Rule Against Perpetuities. The argument between the two perceptions of what constituted a perpetuity runs through the entire case.⁵³

So, the case sustained an interest certain to vest or fail within one life in being at the creation of the interest. Lord Nottingham's memorable opinion stated a principle for testing the validity of executory interests, but left the exact limits of the rule open to further development:

Object. They will perhaps say, where will you stop, if not at *Child* and *Bayly's Case*?

Answ. Where? why everywhere, where there is not any Inconvenience, any Danger of a Perpetuity; and whenever you stop at the Limitation of a Fee upon a Fee, there we will stop in the Limitation of a Term of Years. No Man ever yet said, a Devise to a Man and his Heirs, and if he die without Issue, living *B.* then to *B.* is a naughty Remainder, that is *Pell's* and *Brown's Case*.

Now the *Ultimum Quod Sit*, or the utmost limitation of a fee upon a fee, is not yet plainly determined; but it will be soon found out, if Men shall set their Wits on Work to contrive by Contingencies to do that, which the Law has so long laboured against the Thing will make it self evident, where it is inconvenient, and, God forbid, but that Mischief should be obviated and prevented.

.

But what Time? And where are the Bounds of that Contingency? You may limit, it seems, upon a Contingency to happen in a Life: What if it be limited, if such a one die without Issue within twenty-one Years, or 100 Years, or while *Westminster-Hall* stands? Where will you stop, if you do not stop here? I will tell you where I will stop: I will stop where-ever any visible Inconvenience doth appear; for the just Bounds of a Fee-simple upon a Fee-simple are not yet determined, but the first Inconvenience that ariseth upon it will regulate it.⁵⁴

The case thus laid the foundation for the notions that (a) a perpetuity is a future interest not certain to vest within a specified period and (b) the permissible period is tied to lives in being at the creation of the interest.⁵⁵ Although the Rule grew out of the struggle over free alienability, its final form was not cast precisely in the mold of alienability.⁵⁶

53. Haskins, *supra* note 50, at 37.

54. 22 Eng. Rep. at 953, 960.

55. It is not usually noticed that there were successive limitations to other younger brothers, which Lord Nottingham held invalid without discussion. 22 Eng. Rep. at 931, 963. Under the modern rule these interests would all appear to be good because the brothers would have taken, if at all, within their own lives.

56. J.C. GRAY, *supra* note 22, §§ 2-2.1. There was no suspension of the power of alienation

B. *Evolution of the Rule in North Carolina Gifts Over or "Death Without Issue"*

There have been two generations of North Carolina perpetuities cases, reflecting inevitably the problems associated with common drafting devices of the times. The first generation includes roughly two score cases from the first half of the nineteenth century, almost all of which involved assigned estates in fee tail and gifts over or death without issue.⁵⁷ These cases gave some shape to the emerging North Carolina Rule Against Perpetuities and illustrate some fundamental concepts of the Rule; they will therefore be discussed as a group.

Following the first generation was a gap of more than half a century, broken by only a few perpetuities cases; one may surmise that the perpetuities law relating to gifts over or death without issue had been pretty well settled by the first generation cases, so few appeals were taken during the late nineteenth and early twentieth century. Following the first World War, however, a steady stream of perpetuities cases, numbering nearly fifty, has flowed through our courts.⁵⁸ Most likely this second generation of cases reflects the attempts of draftsmen to facilitate the transfer of increased wealth of the state's citizens and to keep that wealth out of the hands of the federal tax collector.⁵⁹ In this group of cases are found, for example, perpetuities problems associated with trusts, class gifts and powers of appointment, three common tools of the modern estate planner. The second generation cases will be incorporated into the discussion of the elements of the Rule in section II.

As background for the first generation cases, the reader may be helped by a review of two common-law concepts, the estate in fee tail and the indefinite failure of issue construction. The estate in fee tail was created by a conveyance or devise "to A and his bodily heirs," or some similar phrase such as "heirs of the body" or "issue."⁶⁰ The es-

in the *Duke of Norfolk's Case* because the brothers could at any time have joined in a conveyance of all interests in the estate.

⁵⁷ Beginning with *Buton v. Wood*, 10 N.C. (Cam. & Gr.) 300 (1807), and extending through *Blake v. Page*, 61 N.C. 3 (Win.) 223 (1864).

⁵⁸ Beginning with *Living v. Hopkins*, 27 N.C. 486, 80 L.E. 774 (1906), and extending through *Doran v. Rivers*, 37 N.C. App. 242, 152 N.E.2d 571 (1958).

⁵⁹ The federal estate tax enacted as an emergency measure to help finance the Great War was passed in 1916. Act of Sept. 8, 1916, ch. 463 in 11 Stat. 701; Act of Mar. 3, 1917, ch. 154 in 11 Stat. 1000.

⁶⁰ For an introductory discussion of the fee tail, see 1 CRAMER, *supra* note 2, at 45-56; C. WOODHOUSE, *supra* note 41, at 37-41. The term "issue" in many jurisdictions is synonymous with "bodily heirs" and embraces children, grandchildren and other lineal descendants. E.g., *Turpin v. Turner*, 226 N.C. 225, 35 L.E.2d 174 (1946).

tate would last as long as there were lineal descendants ("bodily heirs") of *A*. In effect, *A* took a life estate (he could convey the land to a third person, but the grantee acquired only an estate for *A*'s life), followed by a life estate in his bodily heirs, followed by a life estate in the bodily heirs of *A*'s bodily heirs, and so on.

If the grantor of the estate tail said nothing about what happened when *A*'s line of bodily heirs ran out, there was left, by implication, a reversion in the grantor. On the other hand, the grantor could provide for a gift over upon termination of the fee tail—for example, "to *A* and his bodily heirs, then to *B* and his heirs." In this case *A* would take a fee tail and *B* a vested remainder.⁶¹

Actually, the practice of draftsmen was to introduce the remainder following the estate tail by the language "but if *A* die without issue," so that the conveyance customarily read "to *A* and his bodily heirs, but if *A* die without issue, to *B* and his heirs." The remainder to *B* did not necessarily take effect or fail at *A*'s death; it took effect whenever *A*'s fee tail terminated, that is when *A*'s line of lineal descendants ran out, whenever that might occur. This is known as an indefinite failure of issue (as opposed to a definite failure of issue, which would cause the fee tail to terminate at *A*'s death or some other fixed time).

Now suppose a conveyance "to *A* and *his heirs*, but if *A* die without issue, to *B* and his heirs." For various reasons,⁶² one of them being that the practice of English conveyancers was to use the phrase "but if he die without issue" in limiting remainders after estates tail,⁶³ the indefinite failure of issue construction was put on the grantor's language. It was read as if he had said, "to *A*, but if *A*'s line of lineal descendants runs out, whenever that may occur, to *B*." The result, via the back door, was an estate that lasted as long as *A* had lineal descendants, *viz.* a fee tail in *A*, followed by a remainder in *B*.

Finally, two North Carolina statutes are important to the perpetuities analysis of the first generation cases. The first is the Act of 1784,⁶⁴ converting estates tail into estates in fee simple; the Act is currently codified at G.S. 41-1:⁶⁵

61. 1 L. SIMES & A. SMITH, *supra* note 5, § 142.

62. The possible reasons for the English common law preference for the indefinite failure of issue construction are discussed in *id.* § 522.

63. *Id.*

64. Ch. 22, § 5, *reprinted in* 3 STATE RECORDS OF NORTH CAROLINA (W. Clark ed. 1905) (codified at N.C. GEN. STAT. § 41-1 (1976)).

65. N.C. GEN. STAT. § 41-1 (1976).

Fee tail converted into fee simple. Every person seized of an estate in tail shall be deemed to be seized of the same in fee simple.

The second is the Act of 1827,⁶⁶ reversing the common law presumption of indefinite failure of issue in favor of a presumption of definite failure of issue at the devisee's death. The second Act is currently codified at G.S. 41-4.⁶⁷

Limitations on failure of Issue. - Every contingent limitation in any deed or will, made to depend upon the dying of any person without heir or heirs of the body, or without issue or issues of the body, or without children, or offspring, or descendant, or other relative, shall be held and interpreted a limitation to take effect when such person dies not having such heir, or issue, or child, or offspring, or descendant, or other relative (as the case may be) living at the time of his death, or born to him within ten lunar months thereafter, unless the intention of such limitation be otherwise, and expressly and plainly declared in the face of the deed or will creating it: Provided, that the rule of construction contained in this section shall not extend to any deed or will made and executed before the fifteenth of January, one thousand eight hundred and twenty-eight.

Now for some cases.

A good place to begin is, logically, the beginning: Volume 1 of the *North Carolina Reports*. In that compilation appears the following case:

*Case 1.*⁶⁸ *T* died in 1790⁶⁹ survived by three sons, *A*, *B* and *C*. *T*'s will devised a plantation to *A*, and "if either of my two sons, *A* or *B*, should die without lawful issue begotten of their bodies," *T*'s son *C* "shall have the lands of the one so first dying." *A* died in 1792⁷⁰ without ever having had issue; *A*'s will gave the residue of his estate to his wife. *Held*, the wife took the plantation. The gift over to *C* was too remote, since it was on an indefinite failure of issue.

66. Ch. 7, 1827-1828 N.C. Laws 13 (codified at N.C. GEN. STAT. § 41-4 (1976)).

67. N.C. GEN. STAT. § 41-4 (1976).

68. The paradigm for Case 1 is *Sutton v. Wood*, 1 N.C. (Cam. & Nor.) 399 (1801). Other cases finding remote gifts over on an indefinite failure of issue include *Sanders v. Hyatt*, 8 N.C. (1 Hawks) 247 (1821) (rationale not too clear); *Brown v. Brown*, 25 N.C. (3 Ired.) 134 (1842); *Hollowell v. Kornegay*, 29 N.C. (7 Ired.) 261 (1847); and *Weatherly v. Armfield*, 30 N.C. (8 Ired.) 25 (1847).

The limitation over has been held bad even when the devisee died *before* the testator. *Bryant v. DeBerry*, 3 N.C. (2 Hayw.) 356 (1805). Properly considered, this is not a perpetuities problem at all, but rather one of failure of an interest (by lapse) and its effect, if any, on an executory interest limited upon the failed interest. See W.B. LEACH & J. LOGAN, *supra* note 18, at 440-41.

69. Actually, the opinion is not clear on when *T* died; his will was made in 1790, and the case was decided in 1801. See *Sutton v. Wood*, 1 N.C. (Cam. & Nor.) 399 (1801).

70. Again, the opinion is not clear on when *A* died; his will was made in 1792. *Id.* at 400.

Initially the gift over to *C* appears good. Applying the presumption of indefinite failure of issue,⁷¹ the devise to *A* would be a fee tail, followed by a remainder over to *C*. Although this remainder might first appear to be too remote because *A*'s line of issue (lineal descendants) could last for several centuries before dying out, the ordinary remainder following a fee tail does not violate the Rule Against Perpetuities. Two reasons customarily support the validity of the remainder. First, Gray explains validity on the theory that "[a] future estate [the remainder] which, at all times until it vests, is in the control of the owner of the preceding estate [the fee tail] is, for every purpose of conveyancing, a present estate, and is therefore not obnoxious to the Rule Against Perpetuities."⁷² In other words, because the owner of the fee tail could at any time "dock the entail," that is execute a disentailing conveyance by a fictional lawsuit such as the fine or the common recovery,⁷³ and thereby convert his fee tail into a fee simple absolute,⁷⁴ eliminating the remainder, the property had not been tied up by the grantor. A second explanation for the validity of the remainder following the fee tail is that the remainder is presently vested in interest (although not in possession). "A remainder is vested if, at every moment during its continuance, it becomes a present estate, whenever and however the preceeding freehold estates determine."⁷⁵ In other words, its enjoyment is subject to no condition precedent except termination of the prior particular estate.⁷⁶ According to the common law notion of vestedness, it was not required that the prior estate be certain to terminate: that was not a part of the definition. So the remainder following a fee tail was presently vested and violated no rule against remoteness of vesting.⁷⁷

71. It was argued, unsuccessfully, that *T* had meant a definite failure of issue and intended the gift over to take effect only if *A* died without issue in the lifetime of *B*. *Id.* at 404.

72. J.C. GRAY, *supra* note 22, § 443. On the validity of limitations after estates tail, see generally *id.* §§ 211-212, 443-472.

73. On methods of barring estates tail, see I L. SIMES & A. SMITH, *supra* note 5, § 14.

74. The theory here is akin to the rationale for beginning the perpetuities period at the death of the creator of a revocable inter vivos trust. *See* section II.B.8. *infra*.

75. J.C. GRAY, *supra* note 22, § 9.

76. *Id.* § 970.

77. As stated in I L. SIMES & A. SMITH, *supra* note 5, § 142:

[A] remainder after an estate tail is vested if limited to an ascertained person without words of condition. It is true, the tenant in tail may always have heirs of his body, and thus the remainder may never take effect in possession. Moreover, if the tenant in tail can bar his estate and pass a fee simple, the remainder will be extinguished. Nevertheless such conditions arise purely by implication and are not considered in determining the vested character of the remainder.

See also J.C. GRAY, *supra* note 22, §§ 111(2), 970.

Nevertheless, this fee tail-vested remainder analysis was not available in North Carolina, due to the Act of 1784, which converted estates in tail into estates in fee simple. Thus the fee tail in *A* resulting from an indefinite failure of issue construction was converted by the Act of 1784 into a fee simple.⁷⁸ Note, however, that the statute did not necessarily convert *A*'s fee tail into a fee simple *absolute*. The statute was silent on the question of the nature of *A*'s fee simple, leaving open the possibility of *A*'s taking a defeasible fee simple; indeed, the court in Case 1 found that *A* took a fee simple subject to an executory devise⁷⁹ over to *C* on indefinite failure of issue. For purposes of the Rule Against Perpetuities, executory interests are not "vested" until they become possessory,⁸⁰ so *C*'s gift over on an indefinite failure of issue clearly violated the Rule. Case 1 verifies that in North Carolina the Rule at least is one against remoteness of vesting, and that the meaning of vesting for re-

Dictum in *Sutton v. Wood*, 1 N.C. (Cam. & Nor.) 399, 401-02 (1801), that the remainder is contingent appears incorrect.

78. The court might well have rejected the indefinite failure of issue construction on the ground that the act abolishing fees tail destroyed the underlying rationale for the indefinite construction. The court did not take this approach. See *Sutton v. Wood*, 1 N.C. (Cam. & Nor.) 399, 403 (1801).

On the other hand, there is a separate line of cases straining to sustain the validity of the gift over. These cases reasoned that the abolition of fees tail removed the reason for the strained indefinite failure of issue construction; that the language "if he die without issue" ought therefore to be received in its natural sense, as it was for personality; and that therefore slight evidence of contrary intention was sufficient to rebut the presumption of indefinite failure of issue. Such words as "leaving" or "survivor" were regarded as sufficient to tie up the failure of issue to the life of one in being. *Jones v. Spaight*, 4 N.C. (Car. L. Rep.) 157 (1814); *Zollicoffer v. Zollicoffer*, 20 N.C. (3 & 4 Dev. & Bat.) 574 (1839); *Threadgill v. Ingram*, 23 N.C. (1 Ired. Eq.) 577 (1841); and *Gregory v. Beasley*, 36 N.C. (1 Ired. Eq.) 25 (1840). Compare Cases 2 and 3 *infra*. Thus there appear to be several conflicting lines of decisions. Some of the cases suggest that realty and personality were to be treated differently, others that they were to be treated alike. And if they were to be treated alike, some cases said the real property rules controlled both, while other cases said the personal property rules governed both.

79. Since the prior estate in *A* was a fee simple, not a life estate or a fee tail, the interest in *C* was an executory interest, not a remainder. In the common-law system, remainders followed only "prior particular estates," which did not include defeasible fees. The only remaining category for *C*'s interest, if not a remainder, was an executory interest, here a shifting executory devise. See J. RITCHIE, N. ALFORD & R. EFFLAND, *DECEDENTS' ESTATES AND TRUSTS* 765-71 (5th ed. 1977).

For an excellent discussion of the proposition that the Act of 1784 did not necessarily convert the fee tail into a fee simple absolute, see *Smith v. Brisson*, 90 N.C. 284 (1884). *Smith* states clearly that the reason *A* takes a fee simple absolute is not by operation of the Act of 1784 but rather because of the remoteness of the gift over to *C*. *Id.* at 287. *Smith* also confirms that *C*'s interest is an executory devise, taking effect under the Statute of Uses. *Id.* at 290; accord, *Sessoms v. Sessoms*, 144 N.C. 121, 56 S.E. 687 (1907).

For a true case of repugnancy, see *Roane v. Robinson*, 189 N.C. 628, 127 S.E. 626 (1925), in which the devisee was given, in effect, an unrestricted power of disposition, and the gift over on failure of issue was found to be repugnant to the fee.

80. Leach, *supra* note 29, at 648.

mainders is vesting in interest and for executory interests is vesting in possession.

Case 1 illustrates two other fundamentals of the Rule. One is what Leach has termed the "might-have-been rule." In Case 1, *A* in fact died without ever having had issue, only a few years after *T* and within the life of *C*. If the gift over had been given effect, it would have taken place well within the period of the Rule. Nevertheless, the court did not find it necessary to address this fact; it judged the validity of *C*'s interest by viewing the possibilities from the creation of the interest (*T*'s death) rather than in light of events as they actually occurred.

The other instructive aspect of Case 1 is its handling (or ignoring) of the effect of invalidity of the gift over. The court struck *C*'s remote executory interest from the devise, leaving *A* with a fee simple absolute that was devisable to his wife. The testator had indicated, however, that if *A* died without issue, the plantation was to stay within the family and go over to *C*. This intention could have been accomplished rather roughly in one of two ways: (1) The court might have limited *A* to the original quantum of his estate, a defeasible fee, leaving a power of termination (right of entry) in *T*'s estate if *A* died without issue. This interest would not violate the Rule,⁸¹ and would have passed by descent⁸² to *T*'s heirs, presumably his three children. *C* would thus have gotten a third of the plantation, and only a third would have gone to *A*'s wife. (2) The court might have applied "infectious invalidity" on the theory that *T*'s intentions would better be accomplished by striking the entire devise of the plantation rather than excising only the cancerous part.⁸³ Thus the plantation would have passed by descent to the three children.

Of course, the court discussed neither of these alternatives. Its mechanical approach to the effect of the invalid divesting gift is typical of many perpetuities cases.

*Case 2.*⁸⁴ *T* died in 1800 leaving a will that gave a female slave and all her children, together with all *T*'s lands and half

81. See section VI. *infra*.

82. This assumes that there was no clause in *T*'s will broad enough to have carried the interest.

83. See section II.B.2.b. *infra*.

84. The paradigm for case 2 is *Davidson v. Davidson's Ex'rs*, 8 N.C. (1 Hawks) 163 (1820). *Accord*, *Bailey v. Davis*, 9 N.C. (2 Hawks) 108 (1822); *Rice v. Satterwhite*, 21 N.C. (1 Dev. & Bat. Eq.) 69 (1835); *Lister v. Skinner*, 26 N.C. (4 Ired.) 57 (1843); *Cox v. Marks*, 27 N.C. (5 Ired.) 361 (1845); *Ferrand v. Howard*, 38 N.C. (3 Ired. Eq.) 381 (1844); *Porter v. Ross*, 55 N.C. (2 Jones Eq.) 196 (1855).

of his household furniture and personal estate, to his daughter *A*, and if *A* "dies without having⁸⁵ heirs,⁸⁶ then⁸⁷ . . . the property bequeathed to her shall be divided into four equal parts, between" *T*'s brothers, *B*, *C* and *D*, and the children of *E*. *A* survived *T* but died an infant without ever having had issue. *Held*, *A*'s estate took the property. The gift over was on a remote indefinite failure of issue.

The principal question raised by this case is whether the presumption of indefinite failure of issue applied in Case 1 to real property will be extended in Case 2 to personal property.⁸⁸ The indefinite construction, which "outrages grammar, and what is worse, outrages common sense,"⁸⁹ had some justification for real property when fees tail were commonly sought as a means of keeping estates within the family,⁹⁰ but

85. It was argued that the word "having" would cause the limitation over to take effect at the death of *A*, and that therefore the devise involved a definite failure of issue not violating the Rule. The court did not find this inference strong enough to overcome the usual construction. *Davidson v. Davidson's Ex'rs*, 8 N.C. (1 Hawks) 163, 182 (1820).

86. Note that the gift over was on death without heirs, not death without issue. It was conceded by counsel that "heirs" as used by *T* meant "issue," because the limitation over was to collaterals capable of taking as heirs of *A*, showing that the word "heirs" must have been confined to "issue." *Id.* at 165. For similar cases, see *Sanders v. Hyatt*, 8 N.C. (1 Hawks) 247 (1821); *Rice v. Satterwhite*, 21 N.C. (1 Dev. & Bat. Eq.) 69 (1835).

87. It was also argued that the word "then" confined the failure of issue to *A*'s death. The court did not find that "then" was used as an adverb of time; rather it was merely a grammatical connective. *Davidson v. Davidson's Ex'rs*, 8 N.C. (1 Hawks) 163, 184 (1820).

88. The court treated the case as if it involved personal property only, notwithstanding that the gift included realty as well as personalty. *T* did use the word "bequeathed," and the gift included a female slave and "household furniture and personal estate." *Id.* at 180-81. Slaves may have been regarded as personal property in North Carolina. This view is reflected in the underlying assumptions of the cases involving slaves as property. *E.g.*, *Cutlar v. Cutlar*, 3 N.C. (2 Hayw.) 154 (1801); *Matthews v. Daniel*, 3 N.C. (2 Hayw.) 346 (1801). The assumption is explicit in some early opinions applying the Rule in *Shelley's Case*, in which the distinction between lands, as real property, and slaves, as personal property, was significant. See *Nichols v. Cartwright*, 6 N.C. (2 Mur.) 137 (1812); *Ham v. Ham*, 21 N.C. (1 Dev. & Bat. Eq.) 598, 599-600 (1837); *Floyd v. Thompson*, 20 N.C. (3 & 4 Dev. & Bat.) 616, 618 (1839). See also *Riegel v. Lyster*, 265 N.C. 204, 143 S.E.2d 65 (1965), for a review of these early cases. Some jurisdictions applied real property rules to slaves, though they were always treated as having at least some characteristics of personalty. The majority of slave states regarded slaves as personalty, and some enacted legislation establishing this rule. See generally W. GOODELL, *THE AMERICAN SLAVE CODE* 23-25 (Negro Universities Press ed. 1968) (1st ed. n.p. 1853); 1 L. SIMES & A. SMITH, *supra* note 5, § 357; J.D. WHEELER, *A PRACTICAL TREATISE ON THE LAW OF SLAVERY* 36-41 (Negro Universities Press ed. 1968) (1st ed. n.p. 1837). North Carolina had no determining statute, but went along with the majority rule. See B. HOLT, *THE SUPREME COURT OF NORTH CAROLINA AND SLAVERY* 11 (1970).

If *T*'s gift indeed carried both realty and personalty, the case involves a further point: Does the strength of the indefinite failure of issue construction vary according to the subject matter of the gift? May the same words in a single will mean one thing as applied to realty and another thing as applied to personalty? See note 94 *infra*, for the proposition that they may.

89. *Davidson v. Davidson's Ex'rs*, 8 N.C. (1 Hawks) 163, 187 (1820).

90. See text accompanying notes 33-39 *supra*.

made no sense for personal property—in which fees tail do not exist.⁹¹ The indefinite construction was especially inappropriate for chattels at common law because, the fee tail not being available, the gift over inevitably would be remote. The court might therefore have rejected the indefinite failure of issue construction for personal property,⁹² but it did not do so. Rather, it felt bound to follow the indefinite construction, so that *A* took an “absolute interest” subject to defeasance on a remote (indefinite failure of issue) event. The divesting clause was bad, giving *A* an indefeasible absolute interest in the personal property.

*Case 3.*⁹³ *T* died in 1820. His will bequeathed personal property to his son *A*, and if *A* “dies, leaving no heir lawfully begotten of his body,” *T* gave the property to his wife, *W*, for life, remainder to *B* and *C*. *A* survived *T* but died in his

91. The Statute De Donis Conditionalibus, which sanctioned the fee tail, did not apply to personal property. 1 L. SIMES & A. SMITH, *supra* note 5, §§ 354, 359. The result of an attempt to create a fee tail in personal property was to create what is commonly called an “absolute interest” in the personality. *Id.*

92. Some of the Case 2 decisions appear to be based on rationales other than remoteness (perpetuities); but it is believed that remoteness is the true ground of decision.

One alternative reading is that the attempt to create a fee tail in the legatee of personal property gives the legatee an indefeasible interest in the property, without regard to the limitation over. *Id.* § 359. In other words, the cases appear to be saying that there can be no future interests in personality analogous to executory interests or remainders. While now it is commonly accepted that generally one can have the same present estates and future interests in personality as in realty, for several centuries only limited future interests were recognized in personality. See generally *id.* §§ 351-371. It was accepted, however, that future interests could be created in trusts of personal property. *Id.* § 351. (Case 2, however, did not involve a trust.) Nevertheless, the possible nonexistence of gifts over in personality does not seem to be the real basis of the Case 2 decisions because cases only a few decades later recognized the validity of gifts over in chattels on definite failure of issue. See notes 93-96 *infra*. If executory interests did not exist in chattels, they could not have been sanctioned in the definite failure of issue cases.

It might also be noted that some of the landmark English perpetuities cases involve gifts over on failure of issue in chattels. Both the Duke of Norfolk's Case, 21 Eng. Rep. 665 (Ch. 1682), and *Jee v. Audley*, 29 Eng. Rep. 1186 (Ch. 1787), involve attempted fees tail in chattels real. Both of those cases rest on the proposition that fees tail do not exist in estates for years, so that the gift over cannot automatically be sustained as a remainder. *Norfolk's Case* sustained a gift over that was certain to invest within one life in being, impliedly recognizing the existence of the executory interest. Note, however, that the future interest was (a) equitable, not legal, and (b) in a chattel real, not a chattel personal. *Jee v. Audley* struck down a remote executory interest in a chattel personal on the ground of perpetuities rather than some other ground such as “repugnancy.” The subject of the gift was £1,000, apparently free of trust.

Another reason sometimes given in the Case 2 opinions is that the limitation over is “repugnant” to the first taker's interest. This reason is really no reason at all; it merely announces a conclusion. The fundamental question is why the gift over is repugnant; the reason must be perpetuities because the gifts over are otherwise sustained when the failure of issue is definite.

Finally it might be noted that there is language in the Case 2 paradigm, *Davidson v. Davidson's Ex'rs*, 8 N.C. (1 Hawks) 163 (1820), suggestive of the Rule Against Perpetuities: the words “remote” and “it tended to a perpetuity” are used, and the *Duke of Norfolk's Case* is cited. *Id.* at 181, 186, 187.

93. The paradigm for Case 3 is *Miller v. Williams*, 19 N.C. (2 Dev. & Bat.) 500 (1837). *Accord*, *Gordon v. Holland*, 38 N.C. (3 Ired. Eq.) 362 (1844).

mother's lifetime without ever having had children. *Held*, the gift over to the wife and *B* and *C* was good; the word "leaving" confined the time of the vesting to the death of *A*.

This is one of several cases finding sufficient language to rebut the presumption of indefinite failure of issue. The holding that the word "leaving" indicates a definite failure of issue for gifts of personalty⁹⁴ follows the well-known English case of *Forth v. Chapman*.⁹⁵ Other words and phrases have had similar effect.⁹⁶

94. The same word is not enough to rebut the indefinite construction when the subject of the gift is realty, even when the phrase appears in the same will. *Forth v. Chapman*, 24 Eng. Rep. 559 (Ch. 1720). So the strength of the presumption appears to vary according to the nature of the property given, with the indefinite presumption being more easily overcome in the case of personalty.

95. 24 Eng. Rep. 559 (Ch. 1720) (estate for years). As one of several reasons for the construction, the court said:

[T]he reason why a devise of a freehold to one for life, and if he die without issue, then to another, is determined to be an estate-tail, is in favour of the issue, that such may have it, and the intent take place (vide ante, the case of *Target v. Gaunt*); but that there is the plainest difference betwixt a devise of a freehold, and a devise of a term for years; for in the devise of the latter to one, and if he die without issue, then to another, the words [if he die without issue] cannot be supposed to have been inserted in favour of such issue, since they cannot by any construction have it.

Id. at 560. Compare *Forth v. Chapman*, 24 Eng. Rep. 559 (Ch. 1720), with *Vinson v. Gardner*, 185 N.C. 193, 116 S.E. 412 (1923) (real property). Dictum in *Bailey v. Davis*, 9 N.C. (2 Hawks) 108, 110 (1822), says that the distinction in *Forth v. Chapman* between realty and personalty was no longer followed, but subsequent cases seem to reject that conclusion.

96. Other cases finding sufficient language to rebut the presumption of indefinite failure of issue for personalty include *Watson v. Ogburn*, 22 N.C. (2 Dev. & Bat. Eq.) 353 (1839) ("at her death") (semble); *Baker v. Pender*, 50 N.C. (5 Jones) 351 (1858) ("at her decease"); *Newkirk v. Hawes*, 58 N.C. (5 Jones Eq.) 265 (1859) ("at her decease"); *Blake v. Page*, 60 N.C. (Win.) 252 (1864) ("after her decease"—note that this is weaker than "at her decease"). *Porter v. Ross*, 55 N.C. (2 Jones Eq.) 196 (1855), while finding a remote gift over, classifies the cases as follows:

A work written by Mr. Wade Keyes, of Alabama, on chattels, has recently made its appearance at our bar, where all the doctrine upon this subject is stated and the various cases are lucidly arranged and commented on. At page 138 he arranges, into four classes, the cases in which the general rule is controlled by the intention of the testator. The first is, where the failure of issue is combined with an event personal to the donee; as dying without issue and *unmarried*. The second, where words or phrases are used in the context, which, of themselves, restrict the failure within the prescribed limit. The third class is, where the subject of the gift, necessarily precludes the idea, that any other but a restricted failure, was intended by the donor. The fourth is, where a restriction is raised from the nature of the estate given over by the limitation.

Under these various classes, are arranged the different cases cited by him. This writer, under the second class, observes, that a bequest over to the survivor of *two* persons, after the death of one of them without issue, furnishes the presumption that the testator used the words in their limited sense, and the limitation is not too remote, for it will be intended that the survivor was meant, individually and personally, to enjoy the legacy.

Id. at 197-98. The work cited by the court is W. KEYES, AN ESSAY ON THE LEARNING OF PARTIAL, AND OF FUTURE INTERESTS IN CHATTELS PERSONAL (Montgomery, Ala. 1853).

*Case 4.*⁹⁷ *T* died in 1810,⁹⁸ survived by three children, James, Nancy and Sally. *T*'s will gave certain property⁹⁹ to his daughter Nancy and her heirs,¹⁰⁰ and "in case [Nancy] should die without heir properly begotten, . . . the property should be equally divided between the children then living, whether James . . . or Sally." All three children survived *T*; of the children, James died first, then Nancy died without ever having had issue. *Held*, Sally took the property. "The words '*then living*' tied up the limitation during the lives of the three children."¹⁰¹

This case illustrates the impact of three little words in Gray's statement of the Rule: "No interest is good unless it must vest, *if at all*" The measuring life here is Sally, not Nancy. Even if one presumes an indefinite failure of issue in the gift to Nancy, the gift over to Sally will take effect, *if at all*, within Sally's lifetime. This is because the words "then living" make Sally's interest contingent upon her being alive when the failure of issue takes place. That is, upon the failure of issue, Sally will either be alive and therefore will take, or will be dead and therefore will not take. Thus, Sally will take, if at all, within her own life. The Rule does not require that the devisee in fact take, only that the decision on taking be made within the period of the Rule;¹⁰² the gift must only be certain to vest or fail within the period. If Sally dies before the expiration of Nancy's line of descendants, Sally's interest terminates, so she will take, if at all, within her own life. This theory was not available in Cases 1 through 3, because there the gifts over were not subject to a condition precedent that the remainderman be alive in order to take; even if he were not alive, his estate would have taken.¹⁰³

The preceding explanation of Case 4 squares with standard perpetuities doctrine; however, it is not altogether clear that the "if at all" rationale was in the mind of all the judges in the Case 4 decisions. Some of the opinions seem to be saying that the significance of the

97. The paradigm for Case 4 is *Fortescue v. Satterthwaite*, 23 N.C. (1 Ired.) 566 (1841). *Accord*, *Threadgill v. Ingram*, 23 N.C. (1 Ired.) 577 (1841) (gift over to testator's "surviving children"); *Gregory v. Beasley*, 36 N.C. (1 Ired. Eq.) 25 (1840) (similar).

98. Actually, *T*'s will was made in 1810, *Fortescue v. Satterthwaite*, 23 N.C. (1 Ired.) 566, 568 (1841); the opinion does not indicate when *T* died, but it must have been sometime before 1827.

99. The property consisted of a female slave, a bed and furniture. *Id.* at 566. As to the possible effect of the subject-matter of the gift, see Case 5 *infra*.

100. The words "and her heirs" of course were words of limitation, not words of purchase, and indicated that Nancy took the property in fee. *E.g.*, J. CRIBBET, *supra* note 3, at 41-42.

101. *Fortescue v. Satterthwaite*, 23 N.C. (1 Ired.) 566, 570 (1841).

102. *Baker v. Pender*, 50 N.C. (5 Jones) 351 (1858).

103. *See, e.g.*, *Hollowell v. Kornegay*, 29 N.C. (7 Ired.) 261, 262 (1847).

"then living" condition is that it indicates the testator meant a definite failure of issue.¹⁰⁴ This latter theory has not found currency elsewhere, and indeed is based on the tenuous ground of rebutting a strong presumption. The first theory, which is not dependent on any slippery finding of intention, seems more reliable.

*Case 5.*¹⁰⁵ *T* died sometime before 1805 bequeathing a male slave, a female slave¹⁰⁶ and a horse to her daughter *A*, and if *A* "should depart this life without heir lawfully begotten of her body," the slaves and the horse should belong to *B*. *A* survived *T* but died without having had issue, and her administrator claimed the property. *Held*, the limitation over was too remote and the property vested absolutely in *A*.

Case 5 may be wrong, at least in part. The wrinkle in this case is the property given by *T*: May its nature be examined in determining the certainty of vesting? As to the male slave, if he had been treated as a human being then he would have become the life in being and the gift over would have taken effect, if at all, within his life. As to the female slave, even if she had been treated as a life in being, the gift would not have been saved. A bequest of a female slave included her increase

104. The trial judge "was of the opinion that the limitation in the will was not too remote, but that the words, *then living, whether James, Nancy, or Sally*, tied up the contingency to the death of the first taker without issue." *Fortescue v. Satterthwaite*, 23 N.C. (1 Ired.) 566, 567 (1841). The opinion of the supreme court is not altogether clear:

We agree with the judge that, in this case, the limitation over to Sally, the survivor, of the legacy given to Nancy, on her dying without issue, was not too remote; but that it was a good executory devise. The meaning of the testator is plain, that on any one or two of the children dying without issue, the survivor or survivors, *then living*, whether James, Nancy, or Sally, should have the legacy which had been before given to the one so dying. The contingent interest, if it ever could vest, must necessarily vest during the period of a life or lives that were in being at the death of the testator. The words "*then living*" tie up the limitation during the lives of the three children.

Id. at 570. Compare *Fortescue v. Satterthwaite*, 23 N.C. (1 Ired.) 566 (1841), with *Zollicoffer v. Zollicoffer*, 20 N.C. (3 & 4 Dev. & Bat.) 574 (1839); *Threadgill v. Ingram*, 23 N.C. (1 Ired.) 577 (1841), and *Williams v. McComb*, 38 N.C. (3 Ired. Eq.) 450 (1844). See also W. KEYES, *supra* note 96, at 139-41.

Porter v. Ross, 55 N.C. (2 Jones Eq.) 196 (1855), a personal property case, appears incorrectly decided. There the gift over on death without issue was to the testator's six sons, "or the survivors of them." The court, approaching the matter from the standpoint of construction, found no intention by the testator to limit the failure of issue to the first taker's death and held the gift over remote. Nevertheless, the gifts should have been good on an "if at all" theory even if the failure of issue was general, because the sons would take only if they survived the failure of issue. That the court did not sustain the gift over may indicate that the "if at all" theory was not clearly perceived in the first generation cases and that they were instead based on a tenuous construction of the testator's intention.

105. The paradigm for Case 5 is *Matthews' Adm'r v. Daniel*, 5 N.C. (1 Mur.) 42 (1805).

106. Actually, the case involved only a male slave and a horse. *Id.* at 42. The female slave is postulated because the result may turn on the sex of the slave. See note 107 and accompanying text *infra*.

(but a gift of a male slave did not).¹⁰⁷ So the gift of the female slave could not be tied to her life. As to the horse, it is settled that "lives in being" means human, not animal lives.¹⁰⁸

Gray liked the male slave argument: "[I]t was easier to sneer at the argument than to refute it. It seems unanswerable."¹⁰⁹ There appears to have been no way of saving the gift over of the female slave, but the gift of the horse *should* have been good; there is no policy reason not to base the period of the Rule on lives of animals known to have a shorter life span than human beings. Of course, even under the most favorable view, one of the three gifts (that of the female slave) may have been bad. But that does not mean all gifts should have been held bad. The effect of invalidity of one gift on others is properly a question of construction, not an automatic "infectious invalidity."¹¹⁰

An alternative way of saving the gift over would be via construction. An extraordinary and lengthy Reporter's Note in *1 Murphey* contends that the court should have looked to the subject matter of the bequest as a circumstance from which the intention of the testator might have been inferred: since neither the horse nor the male slave could have lived longer than the period of lives in being plus twenty-

107. One aspect of the practice of slavery gives a partial explanation for the assumption that a slave, like any property, would last indefinitely. The settled rule, apparently, was that a female slave's increase were part of her. Therefore, it could be assumed that a gift of a female slave would last indefinitely, unless her increase were specifically excluded from the gift. See *Williamson v. Daniel*, 25 U.S. (12 Wheat.) 568 (1827). Furthermore, because the question of ownership of the increase became the subject of occasional litigation, the practice of including the expression "and her future increase" became standard. See generally J.D. WHEELER, *supra* note 88, at 23-36.

These assumptions did not necessarily extend to male slaves, however. In *Biscoe v. Biscoe*, 6 G. & J. 232 (Md. 1837), the court distinguished gifts of male and female slaves, on the ground that a male slave's issue were *not* presumed to follow him. It was found that the testator could not have intended a gift over on *indefinite* failure of issue because the gift of a male slave would have to vest, if at all, by the end of the slave's life. The distinction between gifts of male and female slaves became the rule in Maryland. See, e.g., *Hatton v. Weems*, 12 G. & J. 83 (Md. 1841). The North Carolina courts never adopted this theory.

108. 3 L. SIMES & A. SMITH, *supra* note 5, § 1223.

109. J.C. GRAY, *supra* note 22, § 228.

In their casebook, Leach and Logan put the following related case:

L leased Blackacre to *T* for 50 years in 1900 for a lump sum consideration paid in advance. *T* died in 1930 bequeathing the term to *A*, but if liquor should ever be sold on the premises, to *B*. Is *B*'s interest valid?

W.B. LEACH & J. LOGAN, *supra* note 18, at 685, Problem (1). *B*'s interest is good. Since only 20 years remain on the term, all interests must vest in it within less than 21 years.

110. 3 L. SIMES & A. SMITH, *supra* note 5, § 1262. Gray cites a case that held a gift of male and female slaves remote on the ground that the same rule of construction had to apply to both. J.C. GRAY, *supra* note 22, § 228. But why, if the same construction had to be applied to both slaves, was the invalid construction chosen in lieu of the valid one?

one years, the testator must have meant a definite failure of issue.¹¹¹ Since the court did not find a definite failure of issue, the Reporter concluded that the subject matter of the gift will not be looked to as a circumstance from which the testator's intention may be inferred. Perhaps the Reporter was too pessimistic; the intention-oriented argument may not have been made to the court. Other authorities suggest that the subject of the gift does bear on intention.¹¹²

*Case 6.*¹¹³ *T* made his will in 1834, devising a tract of land to his sons William and Rufus, and "if any of my children die without issue, leaving a wife or husband, it is my will that such wife or husband shall be entitled to one half of the property; the other half to be equally divided between my other children or their heirs." *T* had two sons and two daughters. *Held*, the limitation over was not too remote, because the Act of 1827 interpreted the limitation as one to take effect when the sons died, not having issue at the time of their deaths.

This case simply illustrates the effect of the Act of 1827, which established a presumption of definite failure of issue in order to avoid remoteness of the gift over on indefinite failure of issue at common

111. *Matthews' Adm'r v. Daniel*, 5 N.C. (1 Mur.) 42, 42 n.(a) (1805).

An interesting aspect of *Biscoe v. Biscoe*, 6 G. & J. 232 (Md. 1837), and the reporter's note to Case 5 is the appearance of the "lives in being" and "if at all" concepts. Application of the vague "too remote" concept, which North Carolina continued to follow for some time, might have focused the court's attention more on the terms of the bequest, rather than its subject matter. In contrast, if one thinks of lives in being, one cannot help thinking of the slave's life. The "if at all" requirement also encourages one to imagine where the gift itself will be when vesting must occur. Thus, it is possible that the emergence of the concrete statement of the Rule affected the result by influencing the court's assumptions in *Biscoe*.

112. J. C. GRAY, *supra* note 22, §§ 225-229.

113. The paradigm for Case 6 is *Garland v. Watt*, 26 N.C. (4 Ired.) 287 (1844). The first case applying the Act of 1827 appears to be *Tillman v. Sinclair*, 23 N.C. (1 Ired.) 183 (1840). The Act was an alternative ground of decision. The Act of 1827 was prospective. *Brown v. Brown*, 25 N.C. (3 Ired.) 134 (1842).

Cabarrus Bank & Trust Co. v. Finlayson, 286 F.2d 251 (4th Cir. 1961), contains an excellent discussion of the history and purpose of the Act of 1827:

This statute was enacted in 1827 to meet the rule then generally prevailing in this country that a gift over on "death without issue" in a deed or will meant an indefinite failure of issue and hence was void for remoteness. To remedy this situation statutes similar to that of North Carolina were passed in a number of states whereby the defect was cured by directing that such a phrase in a deed or will should be interpreted as a limitation to take effect when such person dies not having such heir, issue, or child living at the time of his death.

Id. at 253. See also *Tillman v. Sinclair*, 23 N.C. (1 Ired.) 183 (1840).

law.¹¹⁴ Occasionally, the 1827 Act has been overlooked¹¹⁵ or even extended to gifts over "if he die."¹¹⁶

114. Some language in Case 6 suggests another approach to validity. The language "leaving a wife or husband" arguably indicates a definite failure of issue because the death is tied to the life of a spouse of William or Rufus. The leading English case on this score is *Pells v. Brown*, 79 Eng. Rep. 504 (K.B. 1620), which involved a devise in the form "to Thomas and his heirs, but if Thomas shall die without issue, *living William*, then to William and his heirs." *Id.* at 505 (emphasis added). The court held that the reference "living William" rebutted the presumption of indefinite failure of issue. *Id.* In Case 6, however, the reference was not to a named spouse, and William or Rufus, under the traditional view of *Jee v. Audley*, 29 Eng. Rep. 1186 (Ch. 1787), might have married someone not in being at *T*'s death. Case 6 does cite *Pells v. Brown* and *Garland v. Watt*, 26 N.C. (4 Ired.) 287, 290 (1844), but perhaps only on the nature of the gift over (an executory devise). Other cases clearly have been based on the Act of 1827. *E.g.*, *Smith v. Brisson*, 90 N.C. 284 (1884) (deed) (excellent explanation); *Sessoms v. Sessoms*, 144 N.C. 121, 56 S.E. 687 (1907) (will of land and slaves; opinion does not distinguish between the two); *Harrell v. Hagan*, 147 N.C. 111, 60 S.E. 909 (1908) (semble); *O'Neal v. Borders*, 170 N.C. 483, 87 S.E. 340 (1915); *Vinson v. Gardner*, 185 N.C. 193, 116 S.E. 412 (1923); *Turpin v. Jarrett*, 226 N.C. 135, 37 S.E.2d 124 (1946) (deed). Occasionally, it is found that the testator used "issue" in the sense of "children," obviating any perpetuities problem. *White v. Alexander*, 290 N.C. 75, 224 S.E.2d 617 (1976) (will; good discussion of the Act of 1827, now N.C. GEN. STAT. § 41-4 (1976)).

115. *E.g.*, *Ex parte McBee*, 63 N.C. 332 (1869); *Elledge v. Parrish*, 224 N.C. 397, 30 S.E.2d 314 (1944).

116. The question upon a testamentary limitation "to *A* and his heirs, but if *A* dies then to *B* and his heirs" is not the same as one involving a gift over "if *A* dies *without issue*." The two cases, nevertheless, are sometimes confused. It is not certain whether *A* will die without issue, but it is certain that *A* will die, so how can one make any sense out of a gift in fee simple absolute to *A* coupled with a clause divesting *A*'s fee on an event certain to occur? Several approaches have been taken, the most sensible one usually being that what *T* meant was "to *A* and his heirs, but if *A* dies *before I die*, to *B* and his heirs." In other words, the gift over was a built-in antilapse provision. This is known as a substitutional construction. *See generally* 1 L. SIMES & A. SMITH, *supra* note 5, § 534.

The usual case on the Act of 1827 deals with the question whether the time of determining failure of issue is at the devisee's death or at some indefinite future time. There are a number of cases, however, involving the question whether the failure of issue is to be determined at the devisee's death or at some *earlier* time: litigants seek to rebut the Act's presumption and apply an earlier time for determining death without issue. In effect, many of them try to substitute "death" for "death without issue" in order to reach a substitutional construction. One of the leading cases in this line is *Hilliard v. Kearney*, 45 N.C. (Busb. Eq.) 221 (1853). *Hilliard* involved a will executed in or before 1775, and therefore decisions under the Act, which applies only to instruments executed after January 15, 1828, did not provide the standard for construction. Richard White bequeathed slaves to his wife for life, remainder to his five daughters, "and if either of them die without an heir, her part to be equally divided among her other sisters." *Id.* at 222. All of the daughters survived the life tenant. One (Mary) died without children, apparently soon after the life tenant, and her share was divided among the four survivors. Subsequently, two sisters (Sarah and Nancy) died leaving children, then one (Elizabeth) died leaving her husband but no children. The survivor, Drucilla, claimed all of Elizabeth's share; Elizabeth's husband claimed it as her administrator; and the representatives of Nancy and Sarah claimed portions of it. The court decided that in the context of the will the term "heirs" must mean "children," so that the question of indefinite failure of issue did not arise.

The opinion discusses in detail three of six constructions that were suggested. The first construction would have caused Elizabeth's share to pass to Drucilla; the second would have caused the share to pass to Nancy's and Sarah's representatives. The other four constructions necessarily resulted in Elizabeth's having had an absolute interest before her death.

Judge Pearson disposed of the first two constructions as being contrary both to the preferred rules of construction and to the apparent intent of the testator. Under the first construction, the will created successive survivorships, so that the shares of all those who died without leaving children ultimately would pass to the last surviving sister. This result was rejected for several reasons. It would require the use of the plural—the *shares* of the *sisters* who died without heir—but the testator used the singular. No estate would vest absolutely until the taker's death, and this

The first generation cases approached the Rule in typical fashion. It was treated as a rule against remoteness of vesting, with vesting defined as vesting in interest for remainders and as vesting in possession for executory interests. The Rule did not insist that the interests actually vest within the period of the Rule, only that they be certain to vest or fail in time. The validity of interests was measured from the crea-

would be contrary to the judicial preference for early vesting, as well as being a possible economic inconvenience when the gift was of slaves and their increase. It was also argued that this construction would prevent the property from passing to the sons. The language of the bequest, however, does not indicate that this was the testator's intent, especially since there was no gift over provided in case of the death without heir of all the daughters. Generally, this construction was found to be contrary to the presumption that the daughters themselves were the primary objects of the testator's bounty.

The second construction argued that the ultimate takers would be the representatives of those who died leaving children: the survivors would divide the shares of those who died without heir in the meantime, but their interest would not be absolute, if at all, until their deaths. The testator's intent was said to be to create a preference for those who died leaving children. This argument was also rejected as being contrary to the preference for early vesting; furthermore, no intent to prefer those who died leaving children appeared in the will.

The other constructions resulted in: (3) absolute vesting at testator's death; (4) absolute vesting at life tenant's death; (5) absolute vesting when the first daughter dies without leaving a child; and (6) absolute vesting in the last two survivors. The court does not discuss what would have happened if one daughter had predeceased the testator, *leaving children*, but there is language to indicate that there would be no gift over to children by implication and that one had to survive the testator in order to take. The court also apparently failed to note that one sister had died without children, having survived the testator and the life tenant. Her share in any case had long ago been distributed to the other daughters, and none of her other heirs appeared to be interested in making a claim on her share.

The holding states that Elizabeth's share vested in her absolutely "at the division." *Id.* at 234. Since this apparently occurred after Mary's death, it is arguably the fifth construction that Judge Pearson was applying. Language in the opinion indicates, however, that Judge Pearson was applying the third construction: absolute vesting in takers living at the death of the testator. *See id.* at 232. This interpretation of the opinion was approved in *Davis v. Parker*, 69 N.C. 271 (1873), and *Murchison v. Whitted*, 87 N.C. 465 (1882).

The fourth construction, absolute vesting on survival of the life tenant, would have been equally applicable in *Hilliard*, and would appear to be the preferred construction under the rule stated by Judge Pearson. He apparently overlooked this possibility. *See Murchison v. Whitted*, 87 N.C. at 470. The sixth construction is dismissed as being both inconvenient and unlikely. Thus, the rule appears to be that the interest should vest in those who survive the testator at his death, whether or not they die leaving heirs. A provision such as this one in Richard White's will is thus regarded as an antilapse provision, rather than as a true survivorship condition. *See id.*

This discussion was rendered largely academic by the adoption of § 41-4 because this rule of construction does not apply to wills under that section. *See Kirkman v. Smith*, 175 N.C. 579, 94 S.E. 423 (1918). It is now provided by statute that a reference to a gift on the death of a taker without children, etc., fixes the time of vesting at the death of that taker. The construction applied in *Hilliard* was argued in *Cabarrus Bank & Trust Co. v. Finlayson*, 286 F.2d 251 (4th Cir. 1961), and was firmly rejected. In abolishing the indefinite failure of issue construction, § 41-4 also established a new rule for determining the time when the absolute interest will vest.

Cases preferring the Act of 1827 over a substitutional construction include *Buchanan v. Buchanan*, 99 N.C. 308, 5 S.E. 430 (1888); *Kornegay v. Morris*, 122 N.C. 199, 29 S.E. 875 (1898) (following *Buchanan v. Buchanan*); *Rees v. Williams*, 165 N.C. 201, 81 S.E. 286 (1914); *Patterson v. McCormick*, 177 N.C. 448, 99 S.E. 401 (1919) (devise in question followed life estate, and it was argued, unsuccessfully, that death of life tenant was time for determining substitution); *House v. House*, 231 N.C. 218, 56 S.E.2d 695 (1949) (in accord with *Patterson v. McCormick*).

tion of the interests, with courts refusing to take into account the events that actually took place. The constructional question of the effect of invalidity of one interest on other valid interests was ignored. The courts were willing to look to constructional questions before reaching perpetuities, but the subject matter of the gift, and its bearing on perpetuities, was ignored.¹¹⁷

II. ELEMENTS OF THE RULE

A. *Statement of the Rule in North Carolina*

Article I, section 34 of the Constitution of North Carolina states: Perpetuities and monopolies are contrary to the genius of a free state and shall not be allowed.¹¹⁸

The same provision was found in the constitutions of 1868 and 1776,¹¹⁹ and similar provisions are included in the constitutions of several other states.¹²⁰

The North Carolina constitutional ban on "perpetuities and monopolies" does not appear to have given any different meaning to the Rule in this state, as compared with traditional formulations;¹²¹ nor do similar constitutional provisions in other states appear to have affected the development of the Rule.¹²² The constitution is cited in an occa-

117. Dukeminier and Johanson state:

Although the indefinite failure of issue construction has been abolished in almost all states and is of very little modern importance, the principles involved . . . are still fundamental. "Indefinite failure of issue" is the equivalent of any remote event that may happen more than 21 years after the death of all living persons.

J. DUKEMINIER & S. JOHANSON, *FAMILY WEALTH TRANSACTIONS: WILLS, TRUSTS AND ESTATES* 992 (2d ed. 1978).

118. N.C. CONST. art. I, § 32.

119. N.C. CONST. of 1868, art. I, § 31; N.C. CONST. of 1776, Declaration of Rights § 23. Those constitutions also included a provision that "[t]he General Assembly shall regulate entails in such manner as to prevent perpetuities." N.C. CONST. of 1868, art. II, § 15; N.C. CONST. of 1776, § 43.

120. ARK. CONST. of 1874, art. 2, § 19; FLA. CONST. of 1838, art. 1, § 24; FLA. CONST. of 1865, art. 1, § 23 (current constitution of Florida omits any perpetuities provision); NEV. CONST. of 1864, art. 15, § 4; PA. CONST. of 1776, § 37; TENN. CONST. of 1870, art. 1, § 22; TEX. CONST. of 1876, art. 1, § 26; VT. CONST. of 1793, ch. 2, § 36; WYO. CONST. of 1890, art. 1, § 30.

121. One might have expected the association of "perpetuities" with "monopolies" to have colored the meaning of perpetuities. Nevertheless, the early cases regarded perpetuities as unbarable estates tail, e.g., *Griffin v. Graham*, 8 N.C. (1 Hawks) 96 (1820), and a similarity between perpetuities and monopolies was found in that each resulted in a tying up of property so that no one had the power to alienate it. See *Yadkin Navigation Co. v. Benton*, 9 N.C. (2 Hawks) 10 (1822). This section was said to protect the vested right of *jus disponendi* and was followed by the Act, passed in the same spirit, converting estates tail into fees simple. *Hughes v. Hodges*, 102 N.C. 236, 9 S.E. 437 (1889). See also *Lane v. Davis*, 2 N.C. (1 Hayw.) 277 (1796); *Minge v. Gilmour*, 2 N.C. (1 Hayw.) 279 (1796). Most of the cases arising under article I, § 34 deal with alleged monopolies, such as exclusive franchises and licenses. See annotations to N.C. CONST. art. I, § 34.

122. For example, the annotations to the Tennessee constitutional proscription of perpetuities

sional perpetuities case,¹²³ but generally it has not been an influencing factor.¹²⁴

The verbal formulation of the Rule in North Carolina has followed much the same path as in other jurisdictions. The first generation cases conceived of perpetuities as unbarrable estates tail, *à la* the *Duke of Norfolk's Case*, and seemed to be applying the "inconvenience" concept of that case.¹²⁵ By the mid-nineteenth century, the cases had moved toward Gray's formulation. From time to time, Mordecai was quoted,¹²⁶ and there was an occasional wistful look at Powell's different formulation of the Rule,¹²⁷ but the second generation cases generally stuck to Gray.¹²⁸

As typically stated, the Rule in North Carolina is:

No devise or grant of a future interest in property is valid unless the title thereto must vest, if at all, not later than twenty-one years, plus the period of gestation, after some life or lives in being at the time of

indicate that common law perpetuities are comprehended by that provision and also cite cases using Gray's formula. *E.g.*, *Chattanooga v. Tennessee Elec. Power Co.*, 172 Tenn. 524, 112 S.W.2d 385 (1938). The annotations to the Texas Constitution also apply the traditional Gray formulation. *Giddings v. Smith*, 15 Vt. 344 (1843), is unusual in that it regards entails as not necessarily perpetuities.

123. *E.g.*, *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 180, 203 S.E.2d 657, 658 (1974).

124. The North Carolina reception statute adopting the common law of England as of the date of the signing of the Declaration of Independence, N.C. GEN. STAT. § 4-1 (1969), does not appear to have affected the Rule or prevented the adoption of Gray's formulation (which first appeared in 1886). This is not unusual. *See Link, supra* note 6, 822-23. For the story of a creative use of a Colorado reception statute to avoid Gray's "if at all" aspect of the Rule, see W.B. LEACH & J. LOGAN, *supra* note 18, at 711.

125. *See* section I.B. *supra*.

126. *E.g.*, *Fuller v. Hedgpeth*, 239 N.C. 370, 377, 80 S.E.2d 18, 23 (1954). Mordecai's formulation ignores the "if at all" aspect of Gray's rule. 1 S. MORDECAI, *supra* note 22, at 588-89: "Every estate must vest during a life or lives in being and twenty-one years—plus the usual period of gestation—thereafter."

127. One court noted:

Professor Richard R. Powell in his work, *Powell on Real Property*, . . . has a very good discussion of the rule. He points out that the rule against perpetuities is a product of the struggle to preserve the alienability of property.

Professor Powell quotes the rule as stated by John Chipman Gray and criticizes it as not being accurate. He contends for a different statement of the rule and his contention has been adopted in the Restatement of Property as follows:

"Thus the rule against perpetuities promotes alienability by destroying future interests which interfere therewith either by eliminating the power of alienation for too long a time or by lessening the probability of alienation for too long a time . . ."

Applying the rule as articulated in this State or as contended for by the Restatement, we believe the result would be the same in this instance.

Wing v. Wachovia Bank & Trust Co., 35 N.C. App. 346, 350, 241 S.E.2d 397, 400 (1978) (quoting RESTATEMENT OF PROPERTY § 370, Comment i (1944)).

128. *E.g., id.* ("We believe that the courts of this State have adopted the rule as stated by John Chipman Gray.").

the creation of the interest. If there is a possibility such future interest may not vest within the time prescribed, the gift or grant is void. The rule refers solely to the vesting of estates and does not concern itself with their possession or enjoyment.¹²⁹

For a time, the formulation was misstated as "not *less* than" rather than "not *later* than," but the mistake did not affect the outcome of any cases.¹³⁰ The second sentence of the formulation is somewhat inconsistent with the "if at all" concept of the first sentence; the matter is discussed below in connection with the elements of the Rule.¹³¹

B. *Elements of the Rule in North Carolina*

1. "No devise or grant of a future interest in property"

a. *In General*

Apparently the Rule originally developed as a check on executory interests in real property, because they were held to be free from the doctrine of destructibility of contingent remainders.¹³² The rule now applies to remainders, as well as executory interests, even if the remainder is subject to destructibility by the common law doctrine or by statute.¹³³ The Rule applies to interests in personal property as well as realty.¹³⁴ Equitable interests as well as legal ones are subject to the Rule,¹³⁵ even

129. *Parker v. Parker*, 252 N.C. 399, 402-03, 113 S.E.2d 899, 902 (1960).

130. Phillips, *Avoiding Some Common Problems of Construction in the Drafting of Dispositive Provisions of Wills*, in INSTITUTE ON DRAFTING LEGAL INSTRUMENTS App. VII-9 n.40 (North Carolina Bar Association 1961) (citations omitted):

Indicative of the elusive quality of the Rule is the very difficulty encountered in stating it accurately and comprehensively. . . . And of purely passing interest is the fact that the North Carolina Supreme Court has in a series of cases, beginning apparently with *McQueen v. Trust Co.* . . . inadvertently misstated Gray's formulation by 180 degrees, stating it "not *less* than" rather than "not *later* than." This quite understandable reversal in form of a formulation already replete with negatives was carried over into *Fuller v. Hedgpath*, *McPherson v. Bank*, *Finch v. Honeycutt*, . . . thence into the advance sheet report of *Parker v. Parker*, . . . being corrected in the bound volume report of this case, and later correctly stated in *Clarke v. Clarke* No substantive result was affected by this inadvertence.

131. See section II.B.4. *infra*.

132. See text accompanying notes 43-45 *supra*.

133. North Carolina may still recognize the doctrine of destructibility of contingent remainders. See McCall, *supra* note 7. Dictum in the fairly recent case of *Blanchard v. Ward*, 244 N.C. 142, 148, 92 S.E.2d 776, 781 (1956), suggests the possibility of destructibility by merger. By statute, the grantor may revoke deeds of future interests made to persons not *in esse*, N.C. GEN. STAT. § 39-6 (1976), or may sell property subject to contingent remainders and reinvest the proceeds, *Id.* § 41-11. Nevertheless, this state continues to apply the Rule Against Perpetuities to contingent remainders. See also 3 L. SIMES & A. SMITH, *supra* note 5, § 1255.

134. *E.g.*, *Stellings v. Autry*, 257 N.C. 303, 126 S.E.2d 140 (1962) (stock).

135. *E.g.*, cases collected in section V. *infra*.

if the trustee has a power of sale.¹³⁶ Class gifts,¹³⁷ powers of appointment,¹³⁸ and interests created by exercise of powers of appointment¹³⁹ are within the Rule. Fiduciary powers run some risk of being subjected to the Rule.¹⁴⁰

Future interests left in the creator of the interest, including reversions, possibilities of reverter and powers of termination (rights of entry), usually are regarded as presently vested and therefore not subject to the Rule.¹⁴¹ Commercial interests such as rights to repurchase, options to repurchase, leases to commence at an uncertain time in the future, and options in gross have been struck down under the Rule, but covenants for perpetual renewal of leases, options to purchase in lessees, easements, profits *à prendre*, expansible easements and pension trusts for employees have escaped the guillotine.¹⁴² In sum, the Rule may apply to interests other than the conventional "future interests" suggested by the typical definition. And the "property" referred to in the definition includes personalty as well as realty and may even extend to some contractual arrangements.¹⁴³

The definition refers to "devises and grants." Clearly the rule may apply to gifts by will of realty (historically called "devises") or of personalty (historically called "bequests" or "legacies").¹⁴⁴ It applies to interests created by deed (grant), as well as to inter vivos trusts and testamentary trusts.¹⁴⁵

b. Charitable Gifts

The blackletter is unequivocal: "[T]he rule against perpetuity does not apply to charitable trusts."¹⁴⁶ This view is codified in G.S. 36A-49.¹⁴⁷

136. See *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 68 S.E.2d 831 (1951). Only Wisconsin frees from the Rule those trusts in which the trustee has the power to sell. *E.g.*, *In re Walker's Will*, 258 Wis. 65, 45 N.W.2d 94 (1950), noted in 49 MICH. L. REV. 1239 (1951); 35 MINN. L. REV. 617 (1951).

137. See section III, *infra*.

138. See section IV, *infra*.

139. *Id.*

140. See notes 321-22 *infra*.

141. See Case 32 *infra*.

142. See section VI, *infra*.

143. *Id.*

144. *E.g.*, *Stellings v. Autry*, 257 N.C. 303, 126 S.E.2d 140 (1962).

145. *Id.*; See section V, *infra*.

146. *Wachovia Bank & Trust Co. v. John Thomasson Constr. Co.*, 275 N.C. 399, 406, 168 S.E.2d 358, 363 (1969).

147. N.C. GEN. STAT. § 36A-49 (Supp. 1977). This statute is merely declarative of the com-

Not void for indefiniteness; title in trustee; vacancies. - No gift, grant, bequest or devise, whether in trust or otherwise, to religious, educational, charitable or benevolent uses or for the purpose of providing for the care or maintenance of any part of any cemetery, public or private, shall be invalid by reason of any indefiniteness or uncertainty of the objects or beneficiaries of such trust, or because said instrument confers upon the trustee or trustees discretionary powers in the selection and designation of the objects or beneficiaries of such trust or in carrying out the purpose thereof, or by reason of the same in contravening any statute or rule against perpetuities.

Other authorities would suggest that this blanket exemption is stated too broadly,¹⁴⁸ but no North Carolina case has invalidated a gift to charity on the ground of perpetuities. The statute may mean literally what it says.

There are almost as many North Carolina perpetuities cases on charitable gifts as on any other aspect of the Rule, and those cases pretty well run the gamut of possible issues. For starters, a perpetual trust for a charity is valid.¹⁴⁹ If the Rule Against Perpetuities does not apply to the duration of a private express trust,¹⁵⁰ seemingly it should not apply to the duration of a charitable trust. There is a difference, however: in the private express trust, all the equitable interests of the beneficiaries must *vest* within the period of the Rule, but in the case of the charitable trust the interests do not vest in any particular beneficiaries.¹⁵¹ A better explanation of the exemption is that outright gifts to charitable corporations are exempt from the Rule,¹⁵² and the charitable trust is not fundamentally different from the charitable corporation—in each form one entity (corporation or trust) holds title for the benefit of the public (charity). Even if the charitable trust is somehow different, the public benefit of the charitable trust outweighs any perpetuities detriment.

In other jurisdictions, when there is a gift to one charity subject to a remote gift over to another charity, both gifts are good, at least when

mon law. *Williams v. Williams*, 215 N.C. 739, 741-42, 3 S.E.334, 337 (1939). Apparently three other states, Michigan, Minnesota and South Carolina, have similar provisions. MICH. STAT. ANN. § 26.1191 (1970); MINN. STAT. ANN. § 501.12 (West 1946); S.C. CODE § 21-27-50 (1976).

148. See 5 R. POWELL, *supra* note 22, ¶ 770[1]; 4A *id.* § 584 (1979).

149. The foundation case is *Griffin v. Graham*, 8 N.C. (1 Hawks) 96 (1820). *Accord*, *State ex rel. Stanly v. McGowen*, (2 Ired. Eq.) 9 (1841); *State ex rel. Wardens of the Poor v. Gerard*, 37 N.C. (2 Ired. Eq.) 210 (1842); *Z. Smith Reynolds Foundation v. Trustees of Wake Forest College*, 227 N.C. 500, 42 S.E.2d 910 (1947).

150. See section V. *infra*.

151. Although in a sense the equitable interest does vest in the charitable purpose.

152. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1279.

the contingency on which the gift shifts is related to charity.¹⁵³ The reason is that a perpetual tying up of property for two charities should be good if a perpetual tying up for one charity is good (and it is).¹⁵⁴ Although no North Carolina cases are squarely in point, undoubtedly this state would follow the usual rule.¹⁵⁵

Given the basic exemption of present gifts for charitable trusts, some variations are possible. The settlor, for example, may provide that the trustee has no power to sell the trust corpus. Here the restraint on alienation is aggravated, since the trustee cannot even sell the particular trust corpus and reinvest the proceeds of sale for the benefit of charity. Nevertheless, the recent case of *Wachovia Bank & Trust Co. v. John Thomasson Construction Co.*¹⁵⁶ sustained the validity of the restriction on the power of sale. Aside from citing cases from other jurisdictions, the court's only reason for reaching this result was that "since North Carolina recognizes that a donor may create a perpetual charitable trust, it would seem strange to deviate from the general rule so as to prevent the donor from restraining sale of the corpus of such trust."¹⁵⁷ This reasoning is not convincing, but it is not unusual.¹⁵⁸ Significantly, the court actually did authorize the sale of the trust corpus, pursuant to the general power of courts of equity to permit sales of property settled in trust for charity,¹⁵⁹ so the validation of the restraint on alienation did not have disastrous consequences.

Now, suppose that instead of allowing immediate use of the charitable gift, the settlor directs accumulation of the income for a specified period of time, say ninety-nine years. Will the accumulation for charity be good? Yes, according to *Penick v. Bank of Wadesboro*,¹⁶⁰ although it is not clear what standard, if any, will be imposed on

153. *E.g.*, 6 ALP, *supra* note 22, § 24.40.

154. 3 L. SIMES & A. SMITH, *supra* note 5, § 1280.

155. *See* *Williams v. Williams*, 215 N.C. 739, 3 S.E.2d 334 (1939); *Z. Smith Reynolds Foundation v. Trustees of Wake Forest College*, 227 N.C. 500, 42 S.E.2d 910 (1947) (contract for payments from one charity over to another).

156. 275 N.C. 399, 168 S.E.2d 358 (1969), *modifying* 3 N.C. App. 157, 164 S.E.2d 519 (1968). The court of appeals held only that the restriction on sale was invalid; the trust itself did not fall.

157. *Id.* at 408, 168 S.E.2d at 364.

158. G. BOGERT, *THE LAW OF TRUSTS & TRUSTEES* § 349, at 683 (rev. 2d ed. 1977).

159. In *John Thomasson*, the court of appeals relied on the decision in *Hass v. Hass*, 195 N.C. 734, 143 S.E. 541 (1928). The supreme court distinguished *Hass* as a case based on the proposition that the words preventing sale ("It is my will that my real estate be not sold . . .") were merely precatory! These decisions overlooked two early cases sustaining perpetual trusts for charity in which the trustee was forbidden to sell the trust corpus. One was the fountainhead charitable case of *Griffin v. Graham*, 8 N.C. (1 Hawks) 96 (1820), and the other was *State ex rel. Wardens of the Poor v. Gerard*, 37 N.C. (2 Ired. Eq.) 210 (1842).

160. 218 N.C. 686, 12 S.E.2d 253 (1940).

accumulations for charity, because the court simply cited the statute that charitable trusts are not subject to the Rule Against Perpetuities. Elsewhere it is said that accumulations for charity are subject to a test of reasonableness,¹⁶¹ while accumulations of income for private beneficiaries may not exceed the period of perpetuities.¹⁶² One would expect some outer limit on accumulations for charity, although it has not yet been reached.

Some caution is advisable in drafting accumulations for charity. *Penick* involved a direct gift to charity, with provision for postponed enjoyment pending accumulation of income. Suppose, however, that the gift to charity was conditional upon the accumulated fund reaching a specified amount. Leach suggests that such a gift would be bad.¹⁶³ This example is just one aspect of the broader question whether a gift to charity on a possibly remote condition precedent would be bad. In other words, the inquiry now shifts away from present gifts to charity, to gifts postponed until the happening of some condition precedent.

The North Carolina cases uniformly have sustained postponed gifts to charity, despite some fairly clear cases of remote conditions precedent. In the accumulation of income situation, gifts were upheld in the following cases: (1) *Griffin v. Graham*,¹⁶⁴ in which the testator directed that as soon as the funds arising from the profits of his estate were deemed sufficient by his executors "a brick house shall be erected . . . for the accommodation of indigent scholars And . . . as soon as the house is finished and the funds arising from the profits of my estate will admit, a proper schoolmaster shall be employed";¹⁶⁵ and (2) *State ex rel. Stanly v. McGowen*,¹⁶⁶ in which the tes-

161. *E.g.*, 6 ALP, *supra* note 22, § 24.42.

162. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1461-1468.

Actually, while there are several cases validating provisions for accumulation within the period of the Rule, there are few cases involving provisions for accumulation for periods longer than the Rule. It does not logically follow that if an accumulation for a period not longer than the Rule is good, an accumulation for a longer period is necessarily bad.

Following the celebrated case of *Thellusson v. Woodford*, 31 Eng. Rep. 117 (Ch. 1798), *aff'd*, 32 Eng. Rep. 1030 (H.L. 1805), Parliament enacted its "Thellusson Act," 39 & 40 Geo. 3, c. 98 (1800), restricting the period of valid private accumulations. Several American states, fearing dynastic trusts created by compound interest-crazed settlers, passed similar statutes. The fears proved unjustified—most Americans just were not Thellusson-minded. Since the statutes restricted certain federal tax advantages of accumulation trusts, most of the American Thellusson Acts have now been repealed. *See generally* 3 L. SIMES & A. SMITH, *supra* § 1466. Apparently North Carolina has never faced the problem.

163. 6 ALP, *supra* note 22, § 24.42. Whether invalidity would merely cut the accumulation provision down to size or completely defeat it is not clear. *Id.*

164. 8 N.C. (1 Hawks) 96 (1820).

165. *Id.* at 98.

166. 37 N.C. (2 Ired. Eq.) 9 (1841).

tator directed that "the net proceeds [of the estate] are then to be kept and put by my executors to the use of a free school."¹⁶⁷ It is not clear whether these holdings reflect a view that the gifts were presently vested with only enjoyment postponed, or whether they represent a general exemption of contingent charitable gifts from the Rule Against Perpetuities. Given the favorable treatment of charities, the courts may be inclined to construe ambiguous language as creating a presently vested interest.¹⁶⁸

The most complete discussion in any North Carolina case of the condition precedent problem came in *Farnan v. First Union National Bank*.¹⁶⁹ The court saved the gift by finding that the only condition precedent (acceptance in writing by the trustee) had to be performed within the period of the Rule and that other apparent conditions precedent merely affected the time of enjoyment. The court's consideration of the issue is some suggestion that the gift would have been bad if the conditions had been remote, although Leach opines that the charitable trust statute would save the gift.¹⁷⁰

About the only charitable trust issue not found in the North Carolina cases is the one that arises when an immediate gift to charity is followed by a remote gift over to a noncharity. In cases of this type, the remote gift over typically fails, leaving the charity with a valid indefeasible estate.¹⁷¹

To summarize, perpetual trusts for charity are valid, even if they forbid alienation of the trust corpus or direct accumulation of the income for a fairly long period. A gift to one charity followed by a gift over to another charity on a remote condition apparently is good, provided the contingency is related to charity. The status of gifts to charity subject to remote conditions precedent is somewhat unclear. North Carolina has never invalidated a charitable gift on perpetuities grounds, and G.S. 36A-49, which exempts charities from the Rule, may be a strong factor. Given the favorable treatment of charities, interests that otherwise might fall afoul of the Rule may be construed as vested, or cy pres may be applied. Charitable gifts are not invalidated merely

167. *Id.* at 11.

168. See 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1282-1285.

169. 263 N.C. 106, 139 S.E.2d 14 (1964). For a full statement of the case, see Case 30 *infra*.

170. 6 ALP, *supra* note 22, § 24.38. A possibly remote gift over to charity was not noticed in *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 203 S.E.2d 657 (1974).

171. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1287.

because the beneficiaries may be remotely ascertained; the focus is on the legal interest in the trustee.

2. "Is valid"

If an interest is not valid it is, logically enough, invalid. That is, the interest is invalid from the time of creation, and it is not cut down to size. There is no cy pres to reform the interest, and to make it approximate as nearly as possible the creator's intention.¹⁷²

There is little consideration of the effect of invalidity of one interest on other valid interests in the North Carolina cases.¹⁷³ Generally, the invalid interest is stricken, leaving the other interest to take effect as if the invalid interest had never been written.¹⁷⁴ The case of the dynastic-minded testator is an instructive example:

*Case 7.*¹⁷⁵ *T*, whose spelling was rather idiosyncratic, devised his farm

to my Grand Sound John W. Clayton . . . to have and to hold his life time, thence to his Body ars if he has Eney and if not then if my Grand Sound Silas . . . if he a living but if J.W. Clayton Shold hav a body hir it Shall go to them down to the Tenth Jenerration"¹⁷⁶

John W. Clayton survived *T* and later died, leaving as heirs nine children. *Held*, the provision in the will restricting the land "down to the Tenth Jenerration" was void, but the prior estate to which it was annexed was valid, giving the nine children a fee simple.

Apparently, the court mechanically excised the invalid limitation, leaving the gift to John W. Clayton's "Body ars if he has Eney," which vested on John's death. A related case seems disposed to sever only the remote part of a single phrase.¹⁷⁷

172. *See, e.g.*, Case 8 *infra*.

173. The standard cases are discussed in Leach, *supra* note 29, at 656-57. Perhaps the most important case is that of alternative contingencies: if two alternative contingencies are stated, one of which is remote and the other is not, and the contingency occurs on which the valid limitation is to take effect, the gift will be good. *Id.* at 657.

174. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1262.

175. Clayton v. Burch, 239 N.C. 386, 80 S.E.2d 29 (1953) (semble).

176. *Id.* at 387-88, 80 S.E.2d at 30.

177. In Jackson v. Powell, 225 N.C. 599, 35 S.E.2d 892 (1942), the testator modestly attempted to entail his estate for a mere three generations: "The grantors hereof make this conveyance to the grantees named above during their natural lifetime then to their bodily heirs to the third generation." *Id.* at 599-600, 35 S.E.2d at 892. The court held the limitation to the third generation to be a violation of the Rule, giving the grantees a fee simple under the Rule in Shelley's Case! The court in effect struck only the words "to the third generation," leaving a gift in the form "to the

When it is difficult to sever the remote interests from the nonremote, the entire gift will fail:

*Case 8.*¹⁷⁸ *T*'s will provided:

Item 7. My will is that all the rest of my property of every description, and my money, be kept by my executor, whomsoever I may appoint; it shall be kept as a fund. Should any of my children or grandchildren come to suffering, in any other way, save by idleness, drunkenness, or anything of the kind, so as to become an object of charity, I want the said executor to give a part of this to such child or grandchild.

Held, whether the administration of the fund by the executor was deemed a power or trust in him, the bequest was void because the fund might have been needed for grandchildren more than twenty-one years after the death of *T*'s children.

Implicit in this case are gifts to: (1) testator's children, all of whom necessarily were lives in being; (2) testator's grandchildren born before his death; and (3) testator's grandchildren born after his death. The court did not separate (1) and (2) from (3), or (1) from (2) and (3), even though either of these alternatives would have saved part of the gift. This automatic result is typical but regrettable.¹⁷⁹

A leading powers of appointment case severed a valid gift of one-half of a remainder from an invalid gift of the other half:

*Case 9.*¹⁸⁰ By his will, *T* left property in trust for his son, William, and provided that "William, shall have the right to dispose of the entire estate . . . by will Should my son die intestate . . . then such estate shall go to [William's surviving] child or children." William's will gave "[a]ll the rest and residue of my estate . . . including [the property subject to the power]" in trust for his children. Upon each child's reaching age twenty-five, one-half of the child's trust was to be distributed in fee to the child, and the remaining one-half was to be held in trust for the benefit of the child for life, with the right to dispose of the remaining one-half share by will to

grantees for life, then to their bodily heirs," which would invoke Shelley's Case. This is an unusual approach, suggesting that in a series of gifts the court might strike only the remote gifts, leaving the prior ones intact. See generally 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1261, 1263.

178. *Moore v. Moore*, 59 N.C. (6 Jones Eq.) 132 (1860).

179. The usual argument against severability is that it cannot be known which plan the testator would have preferred; indeed he might have preferred a different plan (for example, distribution for a period of the lives of his children plus 21 years). Perhaps, but the question at least deserves attention. (Note that total intestacy will result in equality among family branches without regard for the testator's preferences.)

180. *American Trust Co. v. Williamson*, 228 N.C. 458, 46 S.E.2d 104 (1947).

the child's spouse, descendants or charity, and in default of appointment to the child's issue, or if none, to William's surviving issue. William was survived by two children, ages thirteen and ten. *Held*, the gift of the remaining one-half to William's children for life with power to appoint violated the Rule, and the children took that share free of trust under the gift in default in *T*'s will.

The court stated that the provisions were severable without indicating its reasons. This result is in startling contrast to the class gift cases, in which infectious invalidity seems to be the rule. This matter is discussed more fully in connection with class gifts in section III.¹⁸¹ Finally, during the period when North Carolina took the view that trust duration was within the Rule, a remotely long trust failed *in toto*; the court would not limit its duration to a valid period.¹⁸²

3. "Unless the title thereto must vest"

a. *In General*

The Rule Against Perpetuities is a rule against remoteness of vesting. It is not a rule against interests that last too long or against trusts that endure too long,¹⁸³ although one has the lingering suspicion that a court would find some way to strike down a flagrantly long-lasting gift or trust even if all interests vested within the period of the Rule.¹⁸⁴

For perpetuities purposes, "vest" is used in its technical sense of vesting in interest—a remainder is vested in this sense when its possession and enjoyment is subject to no condition precedent other than termination of the prior particular estate.¹⁸⁵ There is one important qualification: for executory interests (as contrasted with remainders),

181. The question of severability was expressly noted in *McPherson v. First & Citizens Nat'l Bank*, 240 N.C. 1, 17, 81 S.E.2d 386, 398 (1954); and *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 181, 203 S.E.2d 657, 659 (1974).

182. *Mercer v. Mercer*, 230 N.C. 101, 104, 52 S.E.2d 229, 231 (1949).

183. Leach, *supra* note 29, at 639-40, 668; see section V. *infra*.

184. For example, (1) *O* conveys to *A* for life, remainder to *A*'s children, to be paid at age 75, or (2) *O* conveys to *A* for life, remainder to *B*, to be distributed to *B* 100 years after *A*'s death.

185. W.B. LEACH & J. LOGAN, *supra* note 18, at 253:

To say that an interest is vested may mean that, although it is still a future interest, it has acquired that metaphysical and artificial status which under the feudal law made it an estate rather than the possibility of becoming an estate—i.e., that it is vested in interest. A remainder is vested in this sense when it is not subject to a condition precedent other than the termination of the particular estate. Executory interests, it is said, do not have the capacity for vesting in interest as remainders do; but this statement is supportable only on historical grounds having no relation to present practical considerations, nor is it really observed by the courts in situations where it counts.

vesting means vesting in possession.¹⁸⁶ The concept of remote vesting breaks down in certain applications of the Rule to commercial interests.¹⁸⁷

The Rule Against Perpetuities is not a rule against suspension of the power of alienation.¹⁸⁸ It is not the same as the rule against restraints on alienation, although both are based at least in part on a policy against withdrawal of property from commerce.¹⁸⁹ The Rule has been used by analogy to check the duration of accumulations of income, although the issue seems not to have arisen in this state.¹⁹⁰

b. Absolute Certainty of Vesting

The interest must be absolutely certain to vest (if at all), on any possibility one can imagine, from the creation of the interest. It is not enough that the interest is highly likely to vest in time, nor that it in fact vests in time. The certainty must exist at the time the interest is created.¹⁹¹ In other words, the test is what might have been, not what actually happened.¹⁹²

Leach has collected a set of bizarre, unanticipated English applications of the Rule, denominated the "fertile octogenarian," the "unborn widow," and the "precocious toddler," in which, by disregarding the facts of life, various interests were invalidated.¹⁹³ A couple in their seventies was presumed capable of having children, a man in his sixties was considered capable of courting and marrying a woman sixty years his junior, and a child of five was deemed capable of producing offspring. None of these exact cases has been litigated in North Carolina, although there are sparse indications that the fantastical presumptions of the English cases would not be followed here. In *McPherson v. First & Citizens National Bank*,¹⁹⁴ the trial court found from the evidence

186. *Id.*; accord, *Poindexter v. Wachovia Bank & Trust Co.*, 258 N.C. 371, 376, 128 S.E.2d 867, 872 (1963) (dictum); *Parker v. Parker*, 252 N.C. 399, 405, 113 S.E.2d 899, 904 (1960) (dictum).

187. See section VI. *infra*.

188. Leach, *supra* note 29, at 640.

189. *Id.* For a strong statement that a perpetuity is an estate settled so that there is no power of alienation in the owner, see the leading case of *Griffin v. Graham*, 8 N.C. (1 Hawks) 96, 131-32 (1820).

190. See note 162 *supra*.

191. Leach, *supra* note 29, at 642-43.

192. See, e.g., *Moore v. Moore*, 59 N.C. (6 Jones Eq.) 132 (1860).

193. Leach, *supra* note 29, at 643-44; Leach, *Perpetuities: The Nutshell Revisited*, 78 HARV. L. REV. 973, 992 (1965). Schuyler points out the absurd assumptions implicit in these cases in Schuyler, *supra* note 38, at 12-16.

194. 240 N.C. 1, 81 S.E.2d 386 (1954).

before it that a fifty-three year old man was physically incapable of having further children. The supreme court reversed this finding because the case was not "sufficiently compelling" to warrant relaxation of the common law presumption that so long as a man lives he is capable of procreation.¹⁹⁵ The court's ruling did not affect the perpetuities issue, however. On the other hand, in *Hicks v. Hicks*,¹⁹⁶ which was not a perpetuities case, evidence was introduced that a seventy-three year old woman had undergone surgery for removal of her ovaries, and her gynecologist testified that it was impossible for her to bear children. The supreme court sustained the trial court finding that the evidence was sufficient to rebut the presumption of procreative ability. The cases are distinguishable in the degree of proof at the trial level and the sex of the person in question. But significantly, both indicate that the common law presumption is rebuttable, in contrast to the rule of the English fertile octogenarian case that no evidence would be heard on the facts of life.¹⁹⁷ Query whether evidence directed to procreative abilities in general, rather than to the particular person in question, would be admissible; it should be relevant.

Another farfetched case of invalidity is the "administration contingency," in which the grantor foresees that some of the objects of his bounty will die during a relatively short period of administration of an estate or trust and so provides that the property will pass only to those beneficiaries who are living when administration is completed or distribution is made. Because it is mathematically possible that administration will take more than the period of perpetuities (which, in the absence of a measuring life, is twenty-one years), the gift may fail.¹⁹⁸

195. The court noted:

Nor have we overlooked Finding of Fact No. 17, wherein the court below found "that it is physically impossible for . . . James E. McPherson to have additional children." On the basis of this finding, without further elaboration or supporting allegation, the court decreed in effect that the living children of James E. McPherson are entitled to all the benefits of the McPherson trust. This decree may not be treated as conclusive in view of the presumption indulged by the law that so long as a man lives he is capable of procreation. . . . Indeed, by the ancient rule of the common law, to which this Court adheres (*Shuford v. Brady* . . .) it is irrebuttably presumed that any person—man or woman—may have issue so long as life lasts. . . . While in many jurisdictions, including England, the question whether the possibility of issue is ever extinct, has been re-examined in the light of exact processes of medical science by which in given cases sterility or impotency may be shown as matters of scientific certainty, nevertheless, thus far this Court has not been presented with a situation sufficiently compelling to warrant relaxation of the common law rule.

Id. at 19, 81 S.E.2d at 398 (citations omitted).

196. 259 N.C. 387, 130 S.E.2d 666 (1963).

197. *Jee v. Audley*, 29 Eng. Rep. 1186 (Ch. 1787).

198. Leach, *supra* note 29, at 644.

For example, suppose the following cases:

*Case 10.*¹⁹⁹ In return for \$200, *H* conveyed to *G* all the timber cut on fifty acres of *H*'s land. *G* was allowed "the full term of five years within which to cut and remove the timber hereby conveyed, said term to commence from the time [*G*] begins to manufacture said timber into wood or lumber." Thirteen years had elapsed without action by *G*. *Held*, the contract created a lease for a term of years, which was void for uncertainty as to when it will commence.

*Case 11.*²⁰⁰ *T* bequeathed the corpus of a trust to named beneficiaries five years after the final decree of distribution of the trust corpus from his executor to the trustee. *Held*, the gift was bad.

Case 12. *T* devised Blackacre to *X* to have and to hold twenty-five years from and after the date of probate of *T*'s will. There are no North Carolina cases in which the issues raised by this hypothetical have been noticed.²⁰¹

Case 13. *T* bequeathed the residue of his estate in trust to pay the debts, taxes and administration expenses of his estate, then to hold the balance for *A*. This fact situation existed in two North Carolina cases, but the issue was not noticed.²⁰²

The invalidation of the contract in Case 10 was consistent with the perpetuities idea that it was uncertain that cutting the timber would commence within twenty-one years (there being no human lives to which the commencement could relate), although the opinion belies that rationale.²⁰³ Case 11 is the celebrated California malpractice case of *Lucas v. Hamm*,²⁰⁴ in which the gift was assumed to be bad because there was a possibility that the decree of distribution might not be entered

199. *Gay Mfg. Co. v. Hobbs*, 128 N.C. 46, 38 S.E. 26 (1901).

200. *Lucas v. Hamm*, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), cert. denied, 368 U.S. 987 (1962). Actually, the exact language of the will appears neither in the supreme court or district court of appeal opinions, see 11 Cal. Rptr. 727 (Dt. Ct. App. 1961), and it was only assumed that the postponement violated the Rule Against Perpetuities. See 14 STAN. L. REV. 580, 581 n.1 (1962). Clearly it violated the California rule against suspension of the power of alienation.

201. The fact situation existed in *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 68 S.E.2d 831 (1951), but the issue was not noticed.

202. *Hass v. Hass*, 195 N.C. 734, 143 S.E.541 (1928), and *Harrison v. Peoples Bank & Trust Co.*, 8 N.C. App. 475, 174 S.E.2d 867 (1970).

203. See text accompanying notes 348-50 *infra*.

204. 56 Cal. 2d, 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), cert. denied, 368 U.S. 987 (1962).

until more than sixteen years after the testator's death. Note that if the gift had been to *named* beneficiaries *if living* five years after the decree of distribution, it would have been good because the beneficiaries would have taken, *if at all*, within their own lives. Apparently the gift was an executory interest, so it could not have been saved on a theory of being vested at the testator's death, with enjoyment merely postponed.

The gift in Case 12 should be good. Even though the will may not be probated within twenty-one years, until it is probated no estates at all are created. The cases are split.²⁰⁵ The gift in Case 13 should also be good. Even though the debts may not be paid for more than twenty-one years, the gift is simply one of the net estate, which is all the testator could give anyway.²⁰⁶

In sum, the draftsman should avoid these administration contingency risks. Although there are various escape theories, such as that the testator contemplated a reasonable time not to exceed the period of the Rule, the North Carolina courts have not clearly indicated how they will approach these farfetched applications.

c. *Construction to Avoid Invalidity*

The Rule Against Perpetuities is a rule of property, not a rule of construction.²⁰⁷ Originally this was held to mean that one could not consider the testator's or grantor's intention.²⁰⁸ In other words, one construes the instrument as if there were no Rule Against Perpetuities and then, having arrived at the construction, one applies the Rule. On the other hand, it is a fair inference that the testator or grantor intended to do a legal act rather than an illegal one; if so, he must have intended not to violate the Rule.²⁰⁹ Accordingly, "[i]f under one construction a devise or bequest would become an illegal perpetuity while under another construction it would be valid and operative, the latter mode *must be preferred*."²¹⁰ The strength of the two North Carolina cases stating

205. See 6 ALP, *supra* note 22, § 24.23.

206. *Id.*

207. *E.g.*, Parker v. Parker, 252 N.C. 399, 406, 113 S.E.2d 899, 904 (1960).

208. The leading English case is Pearks v. Mosely, 5 App. Cas. 714 (H.L. 1880).

209. Compare Leach, *supra* note 29, at 658, with J.C. GRAY, *supra* note 22, §§ 629, 633.

210. Poindexter v. Wachovia Bank & Trust Co., 258 N.C. 371, 377, 128 S.E.2d 867, 872 (1963) (emphasis added); *accord*, Clarke v. Clarke, 253 N.C. 156, 161, 116 S.E.2d 449, 453 (1960); *cf.* Elledge v. Parrish, 224 N.C. 397, 400, 30 S.E.2d 314, 316 (1944) ("In our opinion, the testatrix did not intend a disposition of her property which would violate the rule against perpetuities or entail the estate—not because of a conscious restraint from these prohibited practices, but because her care was for the more immediate objects of her bounty."). In two early cases "or" was construed

this view is difficult to assess. Both *Clarke v. Clarke* (Case 16 in section III. on class gifts)²¹¹ and *Poindexter v. Wachovia Bank & Trust Co.* (Case 29 in section V. on the duration of trusts)²¹² sustained the limitations in question, but other North Carolina cases that seemed ripe for the approach have expressly rejected it.²¹³ Further, the cases that have acknowledged the principle do not consider how one decides whether the testator's expression is really ambiguous. Although of uncertain acceptance and scope, therefore, the principle should be useful to counsel.

One very important case takes a sympathetic approach toward validity:

*Case 14.*²¹⁴ *T* bequeathed stocks in trust for his wife and two daughters for life, with provisions for accumulation of part of the income. On the death of the wife and daughters, part of the income was to be paid to his legal descendants, per stirpes, "until such time as the Law of Perpetuity shall cause this trust to be dissolved," at which time the trustee was to pay the corpus to *T*'s legal descendants, per stirpes. *Held*, the trust was valid. To carry out *T*'s intent, the corpus should be distributed twenty-one years after the death of the last to die of *T*'s two daughters and three grandchildren living at *T*'s death.

The significance of this case is that the court might easily have invalidated the gift, but did not. The court might have said that it did not know who were to be the measuring lives. Or it might have wondered whether the testator meant for the court to wait and see. Or it might have speculated on whether the testator meant only a twenty-one year period in gross beyond the specified life estates. Nevertheless, the court sustained the gift, suggesting that counsel should press the courts for sympathetic rewriting of dubious gifts.

It should be noted that various constructional preferences may support validity in individual cases: the presumption for early vest-

as "and" to avoid invalidity. *Black v. McAulay*, 50 N.C. (5 Jones) 375 (1858); *Montgomery v. Wynns*, 20 N.C. (3 & 4 Dev. & Bat.) 667 (1839).

211. 253 N.C. 156, 116 S.E.2d 449 (1960).

212. 258 N.C. 371, 128 S.E.2d 867 (1963).

213. *See, e.g., Parker v. Parker*, 252 N.C. 399, 113 S.E.2d 899 (1960) (Case 15); *Mercer v. Mercer*, 230 N.C. 101, 52 S.E.2d 229 (1949) (Case 26).

214. *Stellings v. Autry*, 257 N.C. 303, 126 S.E.2d 140 (1962). *See generally* 3 L. SIMES & A. SMITH, *supra* note 5, § 1227. The leading American case reaching a similar conclusion is *Fitchie v. Brown*, 211 U.S. 321 (1908).

ing,²¹⁵ the presumption against intestacy,²¹⁶ and the sympathetic treatment of charitable gifts.²¹⁷

4. "If at all"

The Rule does not require that an interest be certain to vest within the perpetuities period. It requires only that it be certain either to vest or fail within the period of the Rule. If the decision on vesting is made within lives and being plus twenty-one years, the donor's tying up of the property is kept within limits, because at the end of the period it will be known for certain who the owner is. Thus a devise "to my children who shall attain twenty-one" is good, even though it is possible that no child of the testator may ever reach age twenty-one. In a gift "to *A* for life, then to *A*'s children for life, then to *A*'s grandchildren for life, remainder to *X* if he is then living," the gift to *X* should be valid (notwithstanding the remote life estate to *A*'s grandchildren) because *X* will take, *if at all*, within his own life.

Nevertheless, it is not clear that the significance of these three little words is recognized in North Carolina. The second sentence of the usual statement of the Rule in North Carolina ("If there is a possibility such future interest may not vest within the time prescribed, the gift or grant is void.") is inconsistent with the "if at all" concept, and few cases raise the issue. The nearest example is Case 4 in the first generation cases,²¹⁸ and the vest or fail theory may not have been the ground of the decision. Clearly the words must be part of the Rule, because without them all contingent interests would be void.

5. "Not later than twenty-one years"

The period of twenty-one years originally was picked to allow infants to reach their majority. In *Cadell v. Palmer*,²¹⁹ however, the English court allowed a period in gross of twenty-one years unconnected with any minority, and that view has persisted in the United States despite criticism.²²⁰ The twenty-one year period cannot precede the measuring lives.²²¹ The recent general reduction in the age of majority

215. *E.g.*, *Parker v. Parker*, 252 N.C. 399, 403, 113 S.E.2d 899, 902-03 (1960); *Springs v. Hopkins*, 171 N.C. 486, 490, 88 S.E. 774, 776 (1916).

216. *Poindexter v. Wachovia Bank & Trust Co.*, 258 N.C. 371, 377, 128 S.E.2d 867, 872 (1963).

217. *Williams v. Williams*, 215 N.C. 739, 3 S.E.2d 334 (1939); *see* section II.B.1.b.*supra*.

218. *See* text accompanying notes 98-104 *supra*.

219. 6 Eng. Rep. 956 (H.L. 1833).

220. *E.g.*, J.C. GRAY, *supra* note 22, §§ 186-188.

221. Leach, *supra* note 29, at 641.

from twenty-one to eighteen has not affected the Rule;²²² indeed, there is some sentiment for extending the period to thirty or more years to keep property out of the hands of young adults.²²³ Presumably North Carolina would follow the usual period in gross approach, although there is little precedent. One case indicates that a gift does not fail merely because the interest is to vest immediately at the expiration of the period of the Rule rather than at some point within the period.²²⁴

6. "Plus the period of gestation"

This part of the Rule is sometimes stated as "ten lunar months,"²²⁵ but regardless of how stated, only actual periods of gestation are allowed (in contrast to the twenty-one year period in gross unconnected with any minority).²²⁶ It is possible to have children *en ventre* at the beginning of a period as well as the end.²²⁷

7. "After some life or lives in being"

One of the most difficult aspects of the Rule is selecting the measuring lives when none are specified in the instrument. They are those lives, the termination of which may have some effect on vesting.²²⁸ "The measuring lives need not be mentioned in the instrument, need not be holders of previous estates, and need not be connected in any way with the property or the persons designated to take it."²²⁹ For example, a gift to the testator's grandchildren who shall attain the age of twenty-one is good, because all grandchildren must reach age twenty-one within twenty-one years after the death of the testator's (unmentioned) children, who must be lives in being.²³⁰ The lives must be human lives,²³¹ although one would hope for sympathetic treatment of

222. Soled, *Effect of Reduction of the Age of Majority on the Permissible Period of the Rule Against Perpetuities*, 34 MD. L. REV. 245 (1974).

223. Schuyler, *supra* note 38, at 19-20.

224. *Farnan v. First Union Nat'l Bank*, 263 N.C. 106, 111, 139 S.E.2d 14, 17-18 (1964).

225. *E.g.*, *American Trust Co. v. Williamson*, 228 N.C. 458, 463, 46 S.E.2d 104, 108 (1947). The Intestate Succession Act makes heirs of those descendants born within 10 lunar months after the death of the intestate. N.C. GEN. STAT. § 29-9 (1976).

226. *Farnan v. First Union Nat'l Bank*, 263 N.C. 106, 110, 139 S.E.2d 14, 17-18 (1964); *Stellings v. Autry*, 257 N.C. 303, 323, 126 S.E.2d 140, 156 (1962).

227. *See* Leach, *supra* note 29, at 642.

228. Note, *Understanding the Measuring Life in the Rule Against Perpetuities*, 1974 WASH. U.L.Q. 265.

229. Leach, *supra* note 29, at 641.

230. *Id.*

231. J. MORRIS & W.B. LEACH, *THE RULE AGAINST PERPETUITIES* 323 (2d ed. 1962).

a gift measured by the life of an animal having a lifetime shorter than humans.

If the measuring lives are specified in the instrument, the question becomes how many and whose lives may be selected. Again one may select persons who are not takers of any interest, but the number of lives may not be so numerous that it becomes unreasonably difficult to ascertain their termination.²³² The outside limit of validity was the "Royal Lives Clause" of *In re Villar*.²³³ "to my descendants who shall be living 21 years after the death of all lineal descendants of Queen Victoria now [1926] living." Some fairly large classes of measuring lives have been sustained in North Carolina: at least twenty-four persons, including brothers, a sister, nieces, nephews, great nieces and great nephews were considered measuring lives in Case 31;²³⁴ three nieces and one nephew were the measuring lives in Case 30;²³⁵ and two daughters and three grandchildren were used in Case 14.²³⁶ Although the measuring lives in these North Carolina cases were connected with the disposition, under *Villar* they need not have been. This aspect of the Rule has been criticized, because the donor may escape the purpose of the Rule (controlling unreasonable family settlements) by selecting as measuring lives a number of healthy babies unrelated to his family.²³⁷

For purposes of the Rule, the possibility of adoption is disregarded. Adoption was unknown to the common law at the time of development of the Rule, and if the possibility of adopting a beneficiary not in being at the creation of the interest were cognizable, most gifts would violate the Rule. This disregard is similar to the proposition that a power of appointment is not invalid *ab initio* merely because the donee might exercise the power to create remote interests.

232. Leach, *supra* note 29, at 642.

233. [1929] 1 Ch. 243. The same clause in a 1979 English will might be bad, because Queen Victoria's line would be difficult to trace and presumably would include many lives.

234. *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 241 S.E.2d 397 (1978). The court treated the term "last survivor" kindly. Had it been disposed to invalidate the gift, it could have read "last survivor" as meaning the last to die of all lineal descendants of the named beneficiaries.

235. *Farnan v. First Union Nat'l Bank*, 263 N.C. 106, 139 S.E.2d 14 (1964).

236. *Stellings v. Autry*, 257 N.C. 303, 126 S.E.2d 140 (1962).

237. *E.g.*, Schuyler, *supra* note 38, at 9.

8. "At the time of creation of the interest."

For wills the clock starts at the testator's death.²³⁸ For deeds the operative date is the delivery of the deed.²³⁹ Irrevocable trusts are measured from the date of creation of the trust,²⁴⁰ but the clock should not begin to run on revocable trusts until the settlor's death: as long as the settlor is living and has the power to revoke, the trust corpus has not been tied up.²⁴¹

III. CLASS GIFTS

Along with powers of appointment, class gifts are among the most powerful tools of the modern estate planner. Save for the simplest of estates, almost every plan will create future interests in unborn or unascertained beneficiaries who cannot be named specifically but can only be described by reference to their membership in some group.²⁴² This may facilitate generation-skipping²⁴³ or tend to keep the property in the family as long as possible. Even when the client is elderly and the immediate objects of his bounty are ascertained and therefore named individually, it is not uncommon to provide a gift over to a class to guard against intestacy in the event of an untoward sequence of deaths. The application of the Rule Against Perpetuities to class gifts is, therefore, a compelling subject for the estate planner.

The perpetuities doctrines for class gifts fall into several traditional categories, and the North Carolina perpetuities cases appear to line up with the patterns recognized elsewhere. A trio of opinions from the pen of Justice Clifton L. Moore is essential to the understanding of class gifts and perpetuities. The first case illustrates the basic class gift rule.

*Case 15.*²⁴⁴ *T* devised realty to his son in trust²⁴⁵ to pay

238. *E.g.*, *Stellings v. Autry*, 257 N.C. 303, 323, 126 S.E.2d 140, 156 (1962); *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 180, 203 S.E.2d 657, 659 (1974).

239. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1226.

240. *Leach*, *supra* note 29, at 642.

241. *Cook v. Horn*, 214 Ga. 289, 104 S.E.2d 461 (1958).

242. A.J. CASNER, *ESTATE PLANNING* 439-40 (3d ed. 1961).

243. Generation skipping refers to the practice of conferring substantial benefits (*e.g.*, life estates plus special powers of appointment) on successive generations without attendant taxation. If *O* devised property to his children for life, then to his grandchildren for life, remainder to his great-grandchildren (assuming no perpetuities violation), no transfer taxes would be imposed on the children or grandchildren. They had only life estates, which were valueless at their deaths. The Tax Reform Act of 1976 imposes a tax on generation-skipping transfers. I.R.C. §§ 2601-2622.

244. *Parker v. Parker*, 252 N.C. 399, 113 S.E.2d 899 (1960), *noted in* 40 N.C.L. REV. 151 (1961).

245. The son could not have been used as the measuring life because the trust was not personal to him as trustee; at the time of the action a bank had been appointed as successor trustee.

the college expenses of the son's children in such amounts as the son deemed necessary. When the son's youngest child "shall arrive at the age of twenty-eight (28)," the son was to convey the land to the children, "and if any child . . . shall in the meantime have died leaving issue surviving, such issue shall stand for, and represent his [parent], and receive the share that his [parent] would have received."²⁴⁶ At *T*'s death, the son had four children (the youngest being two years old); two children were born later (the youngest being eighteen at the time of the case), and the son was still living. *Held*, the gift violated the Rule Against Perpetuities.²⁴⁷ The gift did not vest until the youngest child of the son reached twenty-eight, which might be more than twenty-one years after the deaths of the son and his four children living at *T*'s death.

This case illustrates the so-called "all-or-nothing rule" of *Leake v. Robinson*.²⁴⁸ That is, a class gift must stand or fall as a unit; if the interest of any member of the class is remote, the entire gift falls. Both maximum and minimum membership in the class must be determined within the period of the Rule.²⁴⁹ In Case 15, the gift to the four children of the son in being at *T*'s death, considered separately, is good; they will reach age twenty-eight, if at all, within their own lives. But the youngest child to reach twenty-eight might be an after-born, and that possibility invalidates the entire gift.²⁵⁰

Apparently no North Carolina case squarely states the all-or-nothing rule in so many words; nevertheless, the result of several cases points clearly in that direction.²⁵¹ The merits (or demerits) of this rule

246. *Parker v. Parker*, 252 N.C. 399, 401, 113 S.E.2d 899, 901 (1960).

247. Apparently, the gift of income was held bad, as well as the gift of the remainder. The income gift was not vested in any child.

248. 35 Eng. Rep. 979 (Ch. 1817).

249. Another case seeming to adopt the rule of *Leake v. Robinson* is *Moore v. Moore*, 59 N.C. (6 Jones Eq.) 132 (1860), in which the testator willed the residue of his estate to his executor, to keep it as a fund and with the further direction that should any of the testator's children or grandchildren "come to suffering . . . I want the said executor to give a part of this to such child or grandchild." *Id.* at 132. The gift was struck down because a grandchild might come to suffering more than 21 years after the deaths of the testator's children. Considered separately, the gift to the testator's children would have been good because they were, perforce, lives in being at their parent's (the testator's) death. Note, too, that had the power to make distribution been restricted to the named executor, the gift would have been good because the executor himself would have been the measuring life. See text accompanying note 276 *infra*.

250. *E.g.*, Leach, *supra* note 29, at 648-49.

251. In addition to *Parker v. Parker*, 252 N.C. 399, 113 S.E.2d 899 (1960), and *Moore v. Moore*, 59 N.C. (6 Jones Eq.) 132 (1860), see *Palmer v. Ketner*, 29 N.C. App. 187, 223 S.E.2d 913 (1976); *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 203 S.E.2d 657 (1974); and *Harrison v. Peoples Bank & Trust Co.*, 8 N.C. App. 475, 174 S.E.2d 867 (1970). Save one, all American

will be considered after discussion of some variations on the basic class gift rule.

Because the Rule Against Perpetuities is a rule against remoteness of vesting, the crucial question in many cases is: When does the vesting take place?

*Case 16.*²⁵² *T* bequeathed fifty percent of his War Bonds "and their accumulation" to the "heirs" of his son, Norman, "to be used for college education only." Any amount left over was to be divided equally among *T*'s named "children" (including Norman). *T* was survived by Norman, who had six minor children at *T*'s death. *Held*, the bequest was good. *T* used the word "heirs" to mean "children." The gift to Norman's children vested at *T*'s death, to the exclusion of after-born children.

Case 16 illustrates two important constructional techniques open to the court to avoid invalidity. First, in construing the class term "heirs" as meaning "children,"²⁵³ the court avoided the invalidity that would have resulted had it construed "heirs" as meaning an indefinite succession of takers from generation to generation.²⁵⁴ Second, by applying

jurisdictions that have considered the question have adopted the rule of *Leake v. Robinson*. 6 ALP, *supra* note 22, § 24.26. The one celebrated exception is *Carter v. Berry*, 243 Miss. 321, 140 So. 2d 843 (1962).

252. *Clarke v. Clarke*, 253 N.C. 156, 116 S.E.2d 449 (1960).

253. The court relied on N.C. GEN. STAT. § 41-6 (1976), which provides that "[a] limitation by . . . will . . . to the heirs of a living person, shall be construed to be to the children of such person, unless a contrary intention appear by the . . . will." The court did not note that the testator used the term "children" elsewhere in the will, suggesting that when he meant "children" he knew how to say it. See *Clarke v. Clarke*, 253 N.C. 156, 157-58, 116 S.E.2d 449, 450-51 (1960). On the other hand, the gift over to the testator's children (including Norman) suggests that the testator did not mean Norman's "heirs" to be read as those who would take Norman's property upon his death.

254. In *Poindexter v. Wachovia Bank & Trust Co.*, 258 N.C. 371, 128 S.E.2d 867 (1963), the testatrix' will provided that if her son "should die leaving issue then his issue shall receive the income from my estate as he did. But if he should leave no issue then . . . [to] my brothers and sisters that is [*sic*] living." *Id.* at 374, 128 S.E.2d at 870. The trial court held that the word "issue" was used to mean "a perpetual succession of lineal descendants" of the son, and that therefore the will violated the Rule Against Perpetuities. *Id.* at 375, 128 S.E.2d at 870-71. Noting the absence of remote issue of the son when the will was made, and the provisions of an earlier will, the North Carolina Supreme Court reversed, holding that "issue" meant only the issue of the son living at his death. Curiously, the court did not take note of N.C. GEN. STAT. § 41-4 (1976), which presumes that a gift over on death without issue is a limitation to take effect when the person dies without issue living at the time of his death. *Cf.* *O'Neal v. Borders*, 170 N.C. 483, 87 S.E. 340 (1915) (relying on § 41-4 to find a definite failure of issue). See generally 2 L. SIMES & A. SMITH, *supra* note 5, § 579.

In *Palmer v. Ketner*, 29 N.C. App. 187, 223 S.E.2d 913 (1976), the testator gave life estates in trust for his wife and youngest sister,

[p]rovided that after all the heirs of my youngest sister have reached their majority, and after this trust has run at least twenty-five year (It is to stay in force more than twenty-five years if all the heirs of my youngest sister have not reached their majority) then the

class closing rules to limit the takers to those children of Norman living at the testator's death, the court avoided the possibility of invalidity created by allowing after-born children to take.²⁵⁵ The all-or-nothing rule requires that both maximum and minimum membership be determined within the period of the Rule. The court closed the class (maximum membership) at Norman's death, citing the usual rule that an immediate (as contrasted to a postponed) gift to a class closes at *T*'s death when there are class members in being who are entitled to take at that time.²⁵⁶ Minimum membership (survivorship) then was no problem because the children would take, if at all, within their own lives.²⁵⁷

At this point, another case is important to constructional issues.

*Case 17.*²⁵⁸ *T* left the residue of his estate in trust for his wife for life, then to his two named daughters for life, "and upon their death their share is to be divided equally between their children when they reach the age of twenty-five years."²⁵⁹ The daughters had five minor children at *T*'s death. *Held*, the residuary gift was good. The remainder to

trustees who are acting at such a time shall liquidate the trust and pay to ~~(look)~~ the heirs ~~(by blood kin of)~~ my sisters Louisa Carpenter, Rena Henry and Leah Palmer per stirpes equal shares share and share alike and not per stirpes . . .

Id. at 189, 223 S.E.2d at 915. The court voided the remainder to the heirs of the three sisters on the ground that their interest would not vest until termination of the trust, which might be 25 years after the death of the youngest sister. *Id.* at 191, 223 S.E.2d at 917 (citing *Parker v. Parker*, 252 N.C. 399, 113 S.E.2d 899 (1960) (Case 15)). The court found some difficulty in reconciling Case 15 with *Roberts v. Northwestern Bank*, 271 N.C. 292, 156 S.E.2d 229 (1967), and it is curious that a technical term such as "heirs" should be given so unusual a meaning. If "heirs" meant heirs in the technical American sense, the remainder would vest on the deaths of the three sisters (all lives in being), subject merely to postponed enjoyment.

255. Even if after-borns shared, the gift would be good if interests vested upon their birth (within the measuring life of Norman), with enjoyment postponed only until they reached college. The court did not consider this possible interpretation. See Case 17 *infra*.

256. *E.g.*, 2 L. SIMES & A. SMITH, *supra* note 5, § 636. Thus when *T* bequeaths personalty "to the children of *A*," and *A* is living and has children at *T*'s death, the class closes at that time so that the shares of *A*'s children can be calculated.

257. *Clarke v. Clarke*, 253 N.C. 156, 161, 116 S.E.2d 449, 453 (1960). The court's decision seemed to overlook the corollary rule that the class will remain open until the time fixed for distribution. *E.g.*, 2 L. SIMES & A. SMITH, *supra* note 5, §§ 640, 643. Thus when *T* bequeaths personalty "to *X* for life, then to the children of *A*," and *X* and *A* are living and *A* has children at *T*'s death, the class does not close until *X*'s death. That is, because of a presumed intent to benefit as many children as possible, the class will remain open until the first class member can demand distribution (in Case 16 when he reaches college). This raises the possibility that Norman's six minor children might die before reaching college, and he might have an afterborn child who would reach college more than 21 years after Norman's death.

Furthermore, *T*'s gift of not just the War Bonds but also "their accumulation" to Norman's heirs may suggest that the testator did not anticipate that vesting would take place at his death. If the gift vested at his death, the beneficiaries would take the accumulation automatically.

258. *Wachovia Bank & Trust Co. v. Taylor*, 225 N.C. 122, 120 S.E.2d 588 (1961), noted in 64 W. VA. L. REV. 91 (1961).

259. *Id.* at 124, 120 S.E.2d at 590.

the grandchildren vested at *T*'s death, subject to open to let in other grandchildren until the death of the daughters. The provision directing division at age twenty-five did not postpone vesting but merely restrained partition.

In Case 17 the early class closing ploy was not available because the gift of the remainder was postponed to let in the life estates in *T*'s wife and daughters; under standard presumptions the class would not close until the deaths of the life tenants,²⁶⁰ so the grandchildren living at *T*'s death could not be used as the measuring lives. Nevertheless, the court upheld the gift, this time on the theory that it was "patent" that *T* intended that immediately upon the death of his daughters their children should have the right of possession, although for reasons satisfactory to him he did not want the land partitioned among his grandchildren until they reached age twenty-five.²⁶¹ The daughters became the measuring lives, with the remainder vesting upon their deaths. Case 17 thus illustrates the use of certain presumptions to construe interests as vested rather than as contingent upon survivorship to a possibly remote date in order to avoid invalidity.²⁶²

In sum, Cases 16 and 17 illustrate three constructional techniques for avoiding perpetuities problems: (1) construing class terms narrowly to exclude remote class members (Case 16); (2) applying class closing (maximum membership) rules to exclude remote after-borns (Case 16); and (3) applying the presumption in favor of early vesting to avoid implied conditions of survivorship (minimum membership) (Case 17). Techniques (2) and (3) are the two sides of the class gift coin. Careful readers no doubt may wonder why neither of these techniques was used to save the gift in Case 15. Indeed, the opinions in Cases 16 and 17

260. *E.g.*, 2 L. SIMES & A. SMITH, *supra* note 5, § 640.

261. The court did not give reasons for its findings of intention. The standard rule of construction is that a gift "when" a beneficiary reaches a specified age (as in Case 17) is contingent upon the beneficiary reaching that age. *Id.* § 586. Furthermore, under the now discredited "divide and pay over rule," when the only words of gift are found in a direction "to divide" (as in Case 17) or "to pay" at a future time, the gift is contingent. *Id.* § 593. The court did not deal with these problems. It has been suggested that the explanation for the decision is that there was an intermediate gift of income to the children, which under standard rules imports vesting. 64 W. VA. L. REV. 91, 93 (1961); see 2 L. SIMES & A. SMITH, *supra* note 5, § 588. This writer has been unable to find any gift of intermediate income in the report of Case 17.

262. If vesting had been postponed until the grandchildren reached 25, the gift to them would have violated the Rule because some after-born grandchildren might not have reached 25 until more than 21 years after their parent's death.

Somewhat similar findings of vested gifts with postponed enjoyment are made in *Fuller v. Hedgpeth*, 239 N.C. 370, 30 S.E.2d 18 (1954), and *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 241 S.E.2d 397 (1978).

struggled with the same question,²⁶³ and one writer has argued for validity of the gift in Case 15.²⁶⁴ For present purposes, suffice it to say that any errors in the class gift perpetuities cases seem not to result from any misunderstanding of standard perpetuities doctrine but rather from doubtful application of class gift rules, which must be decided before one reaches the question of perpetuities. Important class gift rules to keep in mind in closing the class are the rule of convenience that a class will close whenever any member of the class can demand possession and enjoyment of his share,²⁶⁵ and the countervailing presumption that the donor intends to benefit as many class members as possible.²⁶⁶ Important rules in determining minimum membership (survivorship) are the three resolutions in *Clobberie's Case*:²⁶⁷ (1) that a legacy "to be paid at" twenty-one is vested with enjoyment postponed; (2) that a legacy "at" twenty-one is contingent, that is, subject to a condition precedent of reaching twenty-one; and (3) that a legacy "at" twenty-one with "interest" is vested with enjoyment postponed (the gift of interest importing vesting).²⁶⁸ Also significant on survivorship may be the presumption in favor of early vesting.²⁶⁹ The deciding factor, treated in another section of this article,²⁷⁰ may be whether in determining vesting one may incline toward that construction which avoids invalidity; Case 16 announced that view.

Given the general proposition that a class gift must stand or fall as a unit (although various rules of construction for class gifts may ame-

263. According to Case 16, the reason that the devise in Case 15 did not vest in the grandchildren living at the testator's death, closing the class at that time, is that another clause of the will indicated that the gift included after-borns. *Clarke v. Clarke*, 253 N.C. 156, 161-62, 116 S.E.2d 449, 453 (1960).

According to Case 17, the reason that the devise in Case 15 did not vest immediately in grandchildren upon birth, with enjoyment postponed until the youngest reached 28, is that there was no language vesting the interest upon birth. *Wachovia Bank & Trust Co. v. Taylor*, 255 N.C. 122, 128-29, 120 S.E.2d 588, 593-94 (1961). Yet there seems to be no such language in Case 17 either, and there was in Case 15 something of a gift of intermediate income, importing vesting.

264. 40 N.C.L. REV. 151 (1961).

265. 2 L. SIMES & A. SMITH, *supra* note 5, §§ 636, 640.

266. *Id.* § 636.

267. 86 Eng. Rep. 476 (K.B. 1677).

268. 2 L. SIMES & A. SMITH, *supra* note 5, §§ 586, 588.

269. *Id.* § 573. Just why the law should favor the vesting of estates has been difficult to explain. See Rabin, *The Law Favors the Vesting of Estates. Why?*, 65 COLUM. L. REV. 467 (1965). North Carolina has some peculiar decisions in the area of survivorship. See, e.g., *Lawson v. Lawson*, 267 N.C. 643, 148 S.E.2d 546 (1966), noted in 45 N.C.L. REV. 264 (1966) (implying condition precedent of survivorship from existence of express condition precedent unrelated to survivorship; case does not distinguish between wholly different conditions precedent). See 2 L. SIMES & A. SMITH, *supra* note 5, § 594. On class gifts generally, see Long, *Class Gifts in North Carolina*, 22 N.C.L. REV. 297 (1944).

270. See section II.B.3.c. *supra*.

liorate some hardships of that rule), there are two classic exceptions to the all-or-nothing rule, one for a class composed of subclasses and one for per capita gifts.

*Case 18.*²⁷¹ *T* devised property to his wife for life, then to his three named daughters for life with cross-remainders to the surviving daughters, then to his grandchildren for life, "with remainder over to the lawful issue of such grandchild or grandchildren forever" and "in default of such issue" to charity.²⁷² *T* was survived by his wife, the three daughters and one grandchild. No other grandchildren were ever born, and the one grandchild in being at *T*'s death was the last to die, survived by his four children (*T*'s great-grandchildren). *Held*, the remainder to the great-grandchildren violated the Rule Against Perpetuities.

In Case 18 it was contended that the gift was to a class of subclasses (really a number of separate gifts) so that each subclass gift should be considered separately.²⁷³ The court seemed to accept the availability of the subclass theory in general, but noted that it requires that *T* verbally separate the gift into subclasses; here there were no devises "which take effect at different times upon the respective deaths of the life tenants," but only a single gift of the remainder.²⁷⁴ The strongest indication of intention to create subclasses is a distribution per stirpes or by right of representation, rather than per capita.²⁷⁵

Case 18 involved a kind of "vertical" severability, an attempted separation of valid remainders from other invalid remainders. Another

271. *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 203 S.E.2d 657 (1974). The life estates to the daughters and grandchildren were good, the grandchildren's estates vesting at the daughters' deaths.

272. *Id.* at 179, 203 S.E.2d at 658.

273. *Id.* at 181, 203 S.E.2d at 659. Even accepting the subclass argument, the gift to the children of the one grandchild would seem to be remote. That grandchild's parent apparently was one of *T*'s surviving children. Viewed from the time of *T*'s death, she could have had other children who might have lived more than 21 years beyond her death and the death of her first child, postponing the vesting of the ultimate remainder to a remote time. Of course, it turned out that no other grandchildren were born, but that makes no difference except in a "wait-and-see" jurisdiction.

274. *Id.* at 181-82, 203 S.E.2d at 659-60. The gift would have been treated as one to a class of subclasses had it been to *T*'s wife for life, then to his daughters for life, and upon the death of any daughter to pay the income on the share from which the daughter had been receiving income to the daughter's children for life, and upon the death of the daughter's children to distribute the share to the daughter's grandchildren.

275. 3 L. SIMES & A. SMITH, *supra* note 5, § 1267. The foundation subclass case is *Cattlin v. Brown*, 68 Eng. Rep. 1319 (Ch. 1853). To Case 18, compare *Palmer v. Ketner*, 29 N.C. App. 187, 223 S.E.2d 913 (1976) (remainder to heirs of three of testator's sisters "per stirpes [*sic*] equal shares share and share alike and not per stirpes [*sic*]").

case suggests a "horizontal" severability of valid life estates from invalid remainders.²⁷⁶

*Case 19.*²⁷⁷ Article 8 of *T*'s will bequeathed personal property in trust to her son Benjamin for life, and after his death the income to Benjamin's children equally, "with their issue standing in the stead of deceased parents on a per stirpes basis." After the death of Benjamin, any surviving child "who shall then" have been age thirty or over was to be paid his "proportionate share" of the trust corpus.²⁷⁸ For Benjamin's "surviving children"²⁷⁹ who had not reached thirty at Benjamin's death, as each one reached the age of thirty he was to be paid his "proportionate share" of the trust. For children who died before Benjamin or who died after Benjamin but before reaching thirty, and without leaving issue surviving them,²⁸⁰ their "share" of the corpus was to go in equal parts to Benjamin's surviving children and, "on a per stirpes basis," to the surviving issue of any deceased child of Benjamin, this issue "to stand in the stead of the deceased parent as to said parent's equal share." The shares of the surviving issue of a deceased child were subject to retention in trust; "as each one of said issue shall reach the age of twenty-five," he was to receive his share of the remaining corpus.²⁸¹ Finally, the will stated that Benjamin had three children, but that any additional children born to him "shall share equally with these three." Apparently no other children had been born to Benjamin; one of his daughters had a minor child. The trial court held that the Article 8 trust violated the Rule Against Perpetuities; on appeal it was contended that the trust was good or, alternatively, that even if the limitations to the great-grandchildren of *T* were remote, those limitations were sever-

276. See generally Comment, *Separability and the Rule Against Perpetuities*, 77 DICK. L. REV. 277 (1973).

277. *Harrison v. People Bank & Trust Co.*, 8 N.C. App. 475, 174 S.E.2d 867 (1970).

278. *Id.* at 478, 174 S.E.2d at 569.

279. It seemed to be taken for granted that "surviving" meant surviving Benjamin, not surviving *T*. In line with the presumption for early vesting, and in order to benefit as many class members as possible, "surviving" is sometimes read as surviving the testator rather than surviving the life tenant. 2 L. SIMES & A. SMITH, *supra* note 5, § 577 (citing North Carolina cases to the contrary).

280. The testamentary trust seemed to have a gap for the situation in which a child of Benjamin died before Benjamin or died before reaching 30, leaving issue. A gift to the child's issue might be implied. *Id.* § 842 (citing North Carolina cases in accord).

281. *Harrison v. Peoples Bank & Trust Co.*, 8 N.C. App. 475, 478, 174 S.E.2d 867, 869 (1970).

able (horizontal severability) from the limitations to *T*'s grandchildren. *Held*, affirmed. The court did not reach the severability argument because it regarded the limitation to *T*'s unborn grandchildren, or to those grandchildren who had not attained the age of thirty by *T*'s death, as invalid. Even if all of Benjamin's living children had attained thirty at *T*'s death, the limitation over to children born after *T*'s death who attained age thirty was remote.²⁸²

Thus, Case 19 leaves open the horizontal severability question in North Carolina; this article will return to that question at the end of this section. Case 19 also reinforces the conclusion that North Carolina follows the all-or-nothing rule because apparently the entire trust was voided. It seems to jeopardize, however, the Case 18 implication that North Carolina will recognize, in an appropriate case, the class of subclasses exception, because the gift to Benjamin's children seemed ripe for a severed shares approach.²⁸³ Finally, it raises a further question of the effect on class gifts of a remote divesting condition.²⁸⁴

In sum, while the possibility of a class of subclasses or a severed share exception is mentioned in some cases, no case has actually found the exception to apply, and one (Case 19) seemed to overlook it.²⁸⁵ The

282. Apparently, the court struck down the entire Article 8, including the shares of Benjamin's three children living at the death of *T*.

283. The class of Benjamin's children (*T*'s grandchildren) would not be closed at *T*'s death because there was an intervening life estate in Benjamin and *T* expressly provided that all his children were to share, although such provisions sometimes are twisted to mean less than they say. (The phrase "if any additional child or children shall be born to him" could be read as meaning "shall be born to him after the making of this will but before my death." See 2 L. SIMES & A. SMITH, *supra* note 5, § 636.) However, all of Benjamin's children would be ascertained at his death. The three living at *T*'s death would take, if at all, within their own lives. The trust seems to create separate gifts for each child of Benjamin, because it constantly refers to "the share" of each child and repeatedly uses a per stirpital plan of distribution. If the gift indeed is one to subclasses (each child of Benjamin), even the gifts to Benjamin's children unborn at *T*'s death seemed good: the gift of aliquot shares of income to each child imports vesting. Although each unborn child's share is subject to divestiture upon death before reaching 30, that is a remote condition subsequent; the usual rule is that a vested gift subject to a remote condition subsequent ripens into an indefeasibly vested gift when the cancerous remote condition subsequent is excised. 3 *id.* § 1263.

284. See text accompanying notes 293 & 294 *infra*.

285. Both horizontal and vertical severability were implicit in *McPherson v. First & Citizens Nat'l Bank*, 240 N.C. 1, 81 S.E.2d 386 (1954), in which the settlor created an irrevocable inter vivos trust to pay the income to his children for life, then to his grandchildren for life, and at the death of the last living grandchild, remainder to the grandchildren's heirs per stirpes. At the creation of the trust the settlor had four children, no others were born, and the trial court found that it was physically impossible for him to have additional children.

The trial court held that the life estate to the grandchildren (apparently) and the remainder to the grandchildren's heirs were remote, but that the life estates to the children were valid and severable. On the face of it, this decision is sound: the settlor's children necessarily would be born within the settlor's lifetime (vesting their life estates), but children could have been born to the

status of the doctrine in this state is therefore uncertain.

The other classic exception to the all-or-nothing rule is for per capita gifts. This situation seems not to have arisen in North Carolina, but the following case will illustrate it.

*Case 20.*²⁸⁶ *T* bequeathed \$1,000 "to each child of *A* who shall attain the age of thirty." At *T*'s death *A* had one child, *B*, age one, and later another child, *C*, was born. Both *B* and *C* attained age thirty. *Held*, the gift to *B* was good and the gift to *C* was bad. The gifts to *B* and *C* were treated separately, and *B* (a life in being) would take, if at all, within his own life.

Finally, class gifts subject to remote conditions precedent should be distinguished from cases in which the class is bound to be ascertained within the period of the Rule but is subject to a divesting clause in favor of a group that may not be ascertained within the period of the Rule.²⁸⁷ For example:

*Case 21.*²⁸⁸ The settlor conveyed realty in trust to her daughter-in-law for life, then for the children of her son until the youngest child "shall arrive at" the age of twenty-one, and upon arrival of the youngest child at twenty-one, to the children in fee; and in the event of the death of any child without issue,²⁸⁹ "his share shall vest in the" surviving children; and in

settlor after creation of the irrevocable trust, remotely postponing the vesting of the life estates in the grandchildren. Thus, the remainder clearly was remote. On severability, the trust referred to the settlor's children as the "primary beneficiaries," and there were other indications of his intent primarily to benefit them, so severability seemed appropriate.

The supreme court affirmed on remoteness but reversed on severability. The court held that the trial court's award of the trust to the four children of the settlor was to the detriment of possible unborn children of the settlor (even though he was incapable of further procreation!), whose interests were not represented by a guardian ad litem or through the doctrine of virtual representation (the living children being adverse). The case was remanded for consideration of the rights of the settlor's unborn children.

Neither opinion recognized a latent class of subclasses argument, which would have saved the life estates to the grandchildren (but not the remainder over). The settlor's entire plan was per stirpes, with references to the "aliquot part" of each child and gifts to the grandchildren only of the "aliquot part" of each child and gifts to the grandchildren only of the "aliquot part of his or her parent." Thus each child of the settlor (and the child's descendants) was a separate subclass, and the life estates over on the death of the four children in existence when the trust was made should have been good. (Of course, this still would leave open the question of the effect of invalidity of the remainders to the grandchildren's heirs).

286. The leading case is *Storrs v. Benbow*, 43 Eng. Rep. 153 (Ch. 1853). See, e.g., 3 L. SIMES & A. SMITH, *supra* note 5, § 1266.

287. 3 L. SIMES & A. SMITH, *supra* note 5, § 1269; 5 R. POWELL, *supra* note 22, ¶ 782[3].

288. *Springs v. Hopkins*, 171 N.C. 486, 88 S.E. 774 (1916).

289. *Id.* at 487-88, 88 S.E. at 775. The trust did not expressly provide for the case of death of a child with issue.

the event of the death of all of the children without issue in the lifetime of the son, to the son for life, then to certain remaindermen.²⁹⁰ Children were born to the son after the delivery of the deed.²⁹¹ *Held*, the children took vested estates upon the arrival of the youngest child at twenty-one, subject to divestiture upon death without issue.²⁹²

Clearly the gift to the son's children is good because they all must reach twenty-one within twenty-one years after the son's death. Not so clear is the validity of the gifts over upon death of a child without issue. The court apparently regarded the gifts over as valid, but they would seem remote: an after-born child could die without issue more than twenty-one years after the son. If the gift over is remote, it should not affect the validity of the gift to the son's children, which class was fixed within the period of the Rule. This concept was latent in Cases 15 and 19. Case 15 noted, but did not reach, the issue, because the court held the prior gift to the class remote,²⁹³ and Case 19 struck the gift to the class without noting the condition subsequent point.²⁹⁴ Thus, the status of class gifts subject to remote divesting conditions is uncertain in North Carolina.

The North Carolina cases on class gifts may be summarized as follows: (1) by implication they recognize the all-or-nothing rule that a class gift must stand or fall as a unit for perpetuities cases; (2) they apply class closing rules somewhat erratically in the perpetuities cases; (3) they have not applied the wait-and-see approach despite good opportunities to do so;²⁹⁵ (4) they suggest the existence of a class of subclasses exception to the all-or-nothing rule (but lack a square holding that it exists); (5) they have not addressed the per capita gift exception; and (6) they have not dealt adequately with class gifts subject to remote divesting clauses.

On the basic class gift rule and its exceptions, Leach has persuasively shown that the rule of *Leake v. Robinson* is unsound and incon-

290. *Id.* The trust did not expressly provide for the case of death of all the children without issue after the son's death.

291. *Id.* at 490, 88 S.E. at 775. The settlor apparently retained a power to revoke the trust, so the perpetuities clock should not have begun to run until the death of the settlor.

292. *See id.* at 492, 88 S.E. at 777.

293. *Parker v. Parker*, 252 N.C. 399, 405, 113 S.E.2d 899, 904 (1960). The point is discussed in 40 N.C.L. REV. 151, 156 (1961).

294. *Harrison v. Peoples Bank & Trust Co.*, 8 N.C. App. 475, 174 S.E.2d 867 (1970).

295. *See McPherson v. First & Citizens Nat'l Bank*, 240 N.C. 1, 81 S.E.2d 386 (1954); *North Carolina Nat'l Bank v. Norris*, 21 N.C. App. 178, 203 S.E.2d 657 (1974).

sistent with its recognized exceptions.²⁹⁶ It is, in effect, an automatic infectious invalidity, in contrast to the application of the Rule in non-class gift contexts, wherein the effect of partial invalidity on other valid interests is treated as a matter of construction. Under usual perpetuities doctrines, in contrast to the *Leake v. Robinson* rule, when a vested interest is subject to divestment upon a remote contingency, the divesting gift is held invalid and the vested gift becomes indefeasible.²⁹⁷ Leach contends that the *Leake v. Robinson* situation presents a problem of separability—that is, a question of construction regarding the effect of partial invalidity.

Actually, two threads of argument are implicit in the usual criticisms of the rule of *Leake v. Robinson*, one having to do with logical inconsistency and the other with intention. The first thread treats the all-or-nothing rule and its standard exceptions (subclasses and per capita gifts) as more or less automatic rules and argues that there is no sufficient logical difference between the standard case and its exceptions; the difference in result therefore is not justified. This argument leaves open the question of which result (automatic invalidity of the entire class gift or separation of the valid gifts from the invalid) should control in all cases; usually the assumed premise is that separation of the valid and invalid gifts is preferable.

The second thread examines the rule from the standpoint of rules of construction aiming for likely intention. Here it is contended that the *Leake v. Robinson* rule leads to automatic infectious invalidity, in contrast to nonclass gift perpetuities cases in which the effect of invalidity of one interest on other valid interests is treated as a matter of construction, to be examined on a case-by-case basis to ascertain likely intention. Thus, for example, a remote condition subsequent in an individual gift usually leaves the basic gift good, but in the *Leake v. Robinson* situation it invalidates the entire class gift.²⁹⁸

The question therefore boils down to this: Are the class gift rules to be inflexible categories of good and bad, disregarding the creator's intention, or are they to abandon set categories in favor of a de novo

296. Leach, *The Rule Against Perpetuities and Gifts to Classes*, 51 HARV. L. REV. 1329 (1938).

297. See, e.g., *Parker v. Parker*, 252 N.C. 399, 405, 113 S.E.2d 899, 904 (1960).

298. The horizontal severability case, Case 19, illustrates the confusion of these two theories. Usually it is assumed that an invalid remainder over leaves the otherwise valid life estate good. No label is put on the case—it is just assumed that the testator would have preferred to leave the life estate untouched by invalidity of the remainder. Thus, the matter is treated as one of intention. But if the case is argued differently, under a label of "horizontal severability," the court may incline toward invalidity of the life estate on an all-or-nothing theory unless it is convinced that the testator verbally separated the gifts of life estate and remainder.

search for the creator's intention in each case? Certainly there is much to be said for the latter approach; even if the inflexible rule were the generally preferable one of separating the good gifts from the bad (in contrast to the harsh current rule of *Leake v. Robinson*), the creator's intention would sometimes be frustrated.²⁹⁹ Furthermore, if the case is in court anyway, why not go ahead and try best to approximate the creator's plan? By hypothesis, the question of effect of invalidity will not be reached until one first finds a violation of the Rule; to decide the effect of invalidity question would not create any new litigation but would only add an issue to an already disputed case, and that superadded issue is really one that was implicit (though not always recognized) from the start.³⁰⁰

IV. POWERS OF APPOINTMENT

Powers of appointment are immensely useful devices that enable the property owner to control the general devolution of his property while granting a younger generation the power to make specific redistributions to reflect changes in the family, the property, or the economy.³⁰¹ In addition to achieving flexibility, a special power may be

299. Leach puts the following case:

Case 45. T bequeaths the residue of his estate in trust to pay the income to A for life, then to pay the income to the children of A for their lives and upon the death of any child of A to pay the principal upon which such child was receiving the income to the issue of such child. A has two children: C₁ who was born before the death of T, and C₂ who was born after the death of T. Plainly the life estates to both C₁ and C₂ are valid. Equally plainly the remainder to the issue of C₂ is invalid. The question concerns the remainder to the issue of C₁. The share which is to be divided between them will be known at the death of A, since thereafter no children of A can be born; the fraction which each of the issue of C₁ is to take in that share will be known at the death of C₁; therefore, the exact amount to be taken by each of the issue of C₁ will be known within the life of the survivor of A and C₁, both of whom were in being at T's death. The gift to the issue of C₁ is, of itself, valid. The fact that the contemporaneous gift to the issue of C₂ fails is immaterial.

Cases can readily be imagined in which the testator's intention would be more closely approximated by voiding all of the remainders after the life estates to A's children than by validating a portion of [those] remainders. . . . Suppose, for example, that in *Case 45* A is the testator's only child. If the remainder to the issue of C₁ is held valid, it seems likely that such issue will get, directly or indirectly, three-fourths of testator's estate, whereas the issue of C₂ will get one-fourth. Total invalidity of the ultimate remainders would tend to cause a more even distribution among A's grandchildren. However, the reported opinions are curiously lacking in any consideration of this possibility.

6 ALP, *supra* note 22, § 24.29 (footnotes omitted).

300. Arguably litigation of this issue would only add an uncertainty to cases in which the parties agree, without litigation, that the Rule is violated. Nevertheless, because the supposed hard and fast rule of *Leake* and its standard exceptions are shot through with ambiguities and doubtful applications, rendering them unpredictable, it does not seem that much uncertainty would be added to the brew by looking for likely intention.

301. RESTATEMENT OF PROPERTY, Introductory Note, §§ 318-369, at 1808-09 (1940).

employed to give a beneficiary substantial property benefits without accompanying tax detriments.³⁰² A general power of appointment, most often exercisable by will only, is often given to a surviving spouse in conjunction with a life estate to qualify the property subject to the power for the federal estate tax marital deduction, while giving the spouse minimal control over the property.³⁰³ There are not many North Carolina cases applying the Rule Against Perpetuities to powers of appointment, probably because the use of powers is a relatively new development, spurred by the estate tax savings associated with certain plans utilizing powers. Nevertheless, the few cases are classics.

*Case 22.*³⁰⁴ *T's will provided,*

Item 7. My will is that all the rest of my property of every description, and my money, be kept by my executor, whomsoever I may appoint; it shall be kept as a fund. Should any of my children or grandchildren come to suffering, in any other way, save by idleness, drunkenness, or anything of the kind, so as to become an object of charity, I want the said executor to give a part of this to such child or grandchild.³⁰⁵

Held, whether the administration of the fund by the exec-

302. A donee-beneficiary may be given the following benefits in a trust without causing the donee to be treated as owner of the trust property for federal estate tax purposes:

(1) *O's will transfers the legal title to the property to A as trustee. As trustee A has the power of management. He can decide when to sell and in what to reinvest. If the powers are broadly drafted, A can manage the property almost as if he owned it himself.*

(2) *O's will gives to A, not as trustee but as a beneficiary, the following rights and powers:*

(a) *the right to receive all the income;*

(b) *a special power of appointment exercisable by deed to appoint the trust property to anyone A pleases except himself, his creditors, his estate, and the creditors of his estate;*

(c) *a power to consume the trust property measured "by an ascertainable standard relating to the health, education, support or maintenance" of A;*

(d) *a power to withdraw each year \$5,000 or five percent of the corpus, whichever is greater;*

(e) *a special power of appointment exercisable by will to appoint the trust property to anyone A pleases except himself, his creditors, his estate, and the creditors of his estate.*

(3) *If O desires to make sure that A will be able to use the entire property if he needs it, O can appoint an independent cotrustee and give this cotrustee the power to pay A the entire principal or to terminate the trust.*

None of the above powers given A, individually or collectively, causes A to be treated as owner of the trust fund under the federal estate tax.

J. DUKEMINIER & S. JOHANSON, *supra* note 117, at 828 (footnotes omitted); see Lowndes, *Estate Planning and Powers of Appointment*, 30 N.C.L. REV. 225 (1952).

303. I.R.C. § 2056.

304. The paradigm for Case 22 is *Moore v. Moore*, 59 N.C. (6 Jones Eq.) 132 (1860) (Case 8 in section II.B. *supra*).

305. *Id.* at 132.

utor is deemed a power or trust in him, the bequest was void because the fund might have been needed for grandchildren more than twenty-one years after the death of *T*'s children.

Two basic questions are possible in powers cases: (1) Is the power itself good? (2) Assuming the power is good, are the interests created by any exercise of the power good? Case 22 illustrates the first question—validity of the power itself. The classic view is that special powers of appointment (that is, those exercisable in favor of some specified group not including the donee or his estate or the creditors of either³⁰⁶) are bad if they are capable of being exercised beyond the period of the rule. The clock starts when the donor creates the power.³⁰⁷ The underlying theory is that, the power being confined to a limited group specified by the donor, his tying up of the property begins the moment the power is created.³⁰⁸ The power is remote if it is capable of being exercised beyond the period, because exercise of a power is analogous to a shifting executory interest, and executory interests are remote if they are not certain to vest in possession within the period of the Rule.³⁰⁹ The executor's power in Case 22 amounted in substance to a special power of appointment—to give a part of the fund to a member of a limited group specified by *T* (his children or grandchildren). It was void because it was capable of being exercised for the benefit of a grandchild more than twenty-one years after the death of *T*'s children. The court struck down the entire gift, not just the remote gift to grandchildren.³¹⁰

Two handy theories are sometimes available to save the gift, or part of it, in situations like Case 22. If the power is personal to the donee, the gift is good. If, for example, the power in Case 22 was exercisable only by the executor appointed by *T*, and not by any successor executor, the power would perforce be exercised, if at all, within the life of the original executor: he would be the life in being.³¹¹ This question was not addressed in Case 22. A second theory, resulting in partial validity of the gift, would treat the executor's power as comprising a discrete series of powers exercisable on a periodic basis. If, for example, the powers were exercisable annually, only the annual powers ca-

306. See generally 2 L. SIMES & A. SMITH, *supra* note 5, § 875.

307. 3 *id.* § 1273.

308. RESTATEMENT OF PROPERTY § 390, Comment a; § 392, Comment a (1944).

309. 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1236, 1273.

310. As to the effect of remoteness of one interest on another nonremote interest, see section II.B.2.b. *supra*.

311. 3 L. SIMES & A. SMITH, *supra* note 5, § 1277; RESTATEMENT OF PROPERTY § 390, Comment c (1944).

pable of being exercised more than twenty-one years after the deaths of all *T*'s children would be remote.³¹²

The approach to validity of general powers (those exercisable in favor of anyone including the donee, his estate or the creditors of either)³¹³ depends upon whether the general power is exercisable by deed (*inter vivos*) or by will (testamentary). The test for general powers exercisable by deed is whether the power must be *acquired*, if at all, within the period of the Rule; if so, the gift is good. The reason for this rule is that a general power by deed, once acquired, is the equivalent of ownership since the donee could appoint to himself.³¹⁴ Thus, the power is treated like most other interests for perpetuities purposes.

The most difficult case is the general testamentary power. In one sense, it is like a general power exercisable by deed: at the moment of death, the donee may appoint to his estate and freely dispose of the property. Often the donee also has a life estate in the property, and having a life estate plus the power to dispose of the property by will, he

312. 6 ALP, *supra* note 22, § 24.8, at 32-33.

313. The Internal Revenue Code has introduced a new uncertainty into the determination of validity of powers. The common law divided powers into two classes, general and special. General powers were those exercisable in favor of anybody, including the donee or his estate or the creditors of either. Special powers were those exercisable "only in favor of persons, not including the donee, who constitute a group not unreasonably large." RESTATEMENT OF PROPERTY § 320(2)(a) (1940). The Internal Revenue Code defines a special power as any power *not* exercisable in favor of the donee, his estate or the creditors of either. See I.R.C. § 2041. Thus, for federal estate tax purposes, a power to appoint to any person except the donee, his estate, or the creditors of either would be a special power. For property law purposes, the power would not qualify as a special power, because it is not confined to a specific group not unreasonably large. The Restatement labels this kind of power a "hybrid power," RESTATEMENT OF PROPERTY § 320, Comment a (1940); it also goes by trade names such as "world-wide special power."

For perpetuities purposes, should a hybrid power be treated as a general power or a special power? There is little authority on the point. See 5 R. POWELL, *supra* note 22, ¶ 787; McCoid, *The Non-General Power of Appointment*, 7 VAND. L. REV. 53, 62-67 (1953). Powell would treat the power as a special one for perpetuities purposes, since the donee has substantially less than the full equivalent of ownership. On the other hand, the donor of a hybrid power would probably have given the donee a general power, but for adverse federal estate consequences in the donee's estate; in a sense the donor is telling the donee to make up his own mind regarding appointees, free of any group specifications imposed by the donor, so the power could well be treated as general. Further, the hybrid power may ultimately prove to be a general power for federal estate tax purposes. In *State Street Trust Co. v. Kissel*, 302 Mass. 328, 19 N.E.2d 25 (1939), the donee was given a general power to appoint by will, provided that no part of the fund was to be liable for the donee's debts. The donee exercised the power (invoking the usual rule that creditors of the donee of a general power may reach the appointive assets if the power is exercised), and the court held the restriction on creditors to be void, so the power was general, exercised, and subject to creditors' claims. *Kissel* may some day be relied upon to hold the restriction as to creditors in a hybrid power to be ineffective, making the power a general one for federal estate tax purposes. At the least, the *Kissel* risk suggests caution in the use of hybrid powers; rare is the case in which the draftsman cannot specify an adequate group of permissible appointees, not unreasonably large, making the power clearly a special one.

314. 3 L. SIMES & A. SMITH, *supra* note 5, § 1273.

resembles an owner.³¹⁵ On the other hand, the general testamentary power is like a special power in that the holder cannot benefit himself during his lifetime, and if he exercises the power by will, it is likely that the appointment will be in favor of his family.³¹⁶ This latter conception has controlled; general testamentary powers are treated like special powers and are void if capable of being exercised beyond the period of the Rule.³¹⁷

Case 23. *T* bequeathed property in trust for *A* for life, then for the children of *A* for their lives (*A* having no children at *T*'s death) as follows:

- (a) income to *A*'s first child for life;
- (b) income to *A*'s second child for life, as the trustee determines is needed for the child's support, education, maintenance and welfare;
- (c) income to *A*'s third child for life, as the trustee may in his discretion determine.

The trustee was also given a power to sell the trust property and reinvest the proceeds of sale. There are no North Carolina cases in which the issues raised by this hypothetical have been noticed. The gift of income to *A*'s first child and the power of sale in the trustee should be good. There is little authority on the gift of income according to a standard to the second child. The gift of discretionary income to the third child is bad.

This case involves a trust that may last beyond the period of the Rule, since *A*'s children might outlive him by more than twenty-one years. The duration of the trust does not necessarily invalidate it,³¹⁸ but the powers of the trustee may be too remote. The discretionary power to pay income to a child of *A* may amount to a special power of appointment, which is remote if it is capable of being exercised beyond the period of the Rule. Clearly the gift of income to the first child is good; it vests within *A*'s lifetime and is not dependent on the trustee's discretion; no power is involved. Equally clearly, the gift of discretionary income to the third child is bad; it does amount to a special power and can be exercised too remotely.³¹⁹ The gift of discretionary income

315. *Id.* § 1275.

316. *Id.*

317. *Id.* § 1273.

318. See section V. *infra*.

319. See text accompanying notes 306-09 *supra*. The question was latent but went unnoticed

to the second child according to an ascertainable standard is a provocative, unresolved case.³²⁰ On the one hand, since the standard is ascertainable, there appears to be no discretionary power in the trustee. On the other hand, even if the exercise of the trustee's discretion is not regarded as a power, the amount of the income is dependent on future events that may be remote—the needs of the second child for support. But these needs seem no more contingent than the amount of the income to be earned in the future for the first child.

The power to sell in the trustee should be good,³²¹ but sometimes is held bad.³²² It facilitates the free circulation of property, and to strike down administrative powers of a trustee that might last beyond the period of the Rule would strip the trustee of all powers save those granted by statute or court of equity.

*Case 24.*³²³ By his will, *T* left property in trust for his son, William, and provided that "William, shall have the right to dispose of the entire estate . . . by will Should my son die intestate . . . then such estate shall go to [William's surviving] child or children."³²⁴ William's will gave "[a]ll the rest and residue of my estate . . . including [the property subject to the power]" in trust for his children.³²⁵ Upon each child's reaching age twenty-five, one-half of the child's trust was to be distributed in fee to the child, and the remaining one-half was to be held in trust for the benefit of the child for life, with the right to dispose of the remaining one-half share by will to the child's spouse, descendants or charity, and in default of appointment to the child's issue, or if none, to William's surviving issue. William was survived by two children, ages thirteen and ten. *Held*, the gift of the remaining one-half to William's children for life with power to appoint violated the Rule, and the children took that share free of trust under

in *Wachovia Bank & Trust Co. v. Andrews*, 264 N.C. 531, 142 S.E.2d 182 (1965); *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 241 S.E.2d 397, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978).

320. *See Seaver v. Fitzgerald*, 141 Mass. 401, 6 N.E. 73 (1886); T. BERGIN & P. HASKELL, *supra* note 22, 205 n.66. The issue was latent but unrecognized in *Mercer v. Mercer*, 230 N.C. 101, 52 S.E.2d 229 (1949).

321. 3 L. SIMES & A. SMITH, *supra* note 5, § 1277.

322. Leach, *supra* note 29, at 664.

323. The paradigm for Case 24 is *American Trust Co. v. Williamson*, 228 N.C. 458, 46 S.E.2d 104 (1948)(Case 9 in section II.B. *supra*).

324. *Id.* at 459-60, 46 S.E.2d at 105.

325. *Id.* at 460, 46 S.E.2d at 106.

the gift in default in *T*'s will.³²⁶

Case 24 is a veritable teacher's garden (or weed patch, depending on one's point of view) of perpetuities and powers issues, many of which went unnoticed by the court. Perhaps most significantly, the case involves the validity of interests created by exercise of powers of appointment. The court held, with respect to the power in William, that the Rule related back to the time the power was created, not to the date of its exercise. This is the standard view for special powers—the appointment is read back into the creating instrument, and the period is computed from creation of the power.³²⁷ The rationale is that, the power being special, the donor has controlled the disposition and the donee is in effect merely his agent.³²⁸ For general powers by deed, the approach is different. The period is computed from the date of exercise of the power,³²⁹ since the donee is in substance the owner of the property subject to the power.³³⁰ Of course, William's power was neither special nor general by deed; it was a general testamentary power. The arguments over whether to measure validity of interests created by exercise of a general testamentary power by the special power rule or the general power by deed rule are similar to those discussed in connection with determining validity of the power itself. Case 24 follows the majority view in treating the general testamentary power like a special power for purposes of determining validity of appointed interests, just as most cases treat the general testamentary power like a special power for purposes of determining the validity of the power itself.³³¹ This is one significant aspect of the case.

Now, if the interests appointed by William are read back into *T*'s will, were they remote? The disposition of the first half of *T*'s estate to William's children at age twenty-five was not challenged.³³² Why?

326. *Id.* at 464, 46 S.E.2d at 108.

327. 3 L. SIMES & A. SMITH, *supra* note 5, § 1274.

328. *Id.* *White v. White*, 189 N.C. 236, 126 S.E. 612 (1925), although not a perpetuities case, states that the appointee under a general testamentary power takes from the donor, not the donee.

329. 3 L. SIMES & A. SMITH, *supra* note 5, § 1274.

330. *Id.*

331. *Id.* § 1275. The perpetuities problems involved in the exercise of a general testamentary power may arise even when the donee of the power believes he has not exercised it. Section 31-43 provides that a general gift by will operates as an execution of any powers of appointment the testator may have, unless a contrary intention appears in the will. N.C. GEN. STAT. § 31-43 (1976). The section applies only to general powers, *Wachovia Bank & Trust Co. v. Hunt*, 267 N.C. 173, 148 S.E.2d 41 (1966), but apparently extends to general testamentary powers as well as inter vivos ones. Perpetuities problems would appear to be fairly likely when a testamentary power is exercised unknowingly. For general powers by deed, perpetuities problems are unlikely because the clock does not start running until the death of the donee.

332. *American Trust Co. v. Williamson*, 228 N.C. 458, 462, 46 S.E.2d 104, 107 (1948).

Apparently the bequest was contingent upon the childrens' attaining age twenty-five,³³³ and William could have had more children after *T*'s death, who might not have reached twenty-five, if at all, within twenty-one years after William's death; thus, the contingent interest looks remote. The reason for validity must have been the "second-look doctrine," the doctrine that in determining the validity of interests created by exercise of a power of appointment, one may take into account facts existing at the time the power is exercised, even though the period runs from creation of the power.³³⁴ The theory behind the doctrine is that since one has to wait until the power is exercised to determine validity of the appointed interests, one ought to be allowed to take into account facts known at that time.³³⁵ In Case 24, a second look at the time of William's death when the power was exercised reveals that William's children were thirteen and ten years old; they would therefore attain age twenty-five, if at all, within twelve and fifteen years, respectively, of William's death, well within twenty-one years after some life in being (William).³³⁶ Although the second look doctrine is not discussed, Case 24 is the best and only indication that the doctrine is followed in North Carolina.

In passing it might be noted that a significant recent issue not raised by any North Carolina cases is whether the second look doctrine may be applied in determining the validity of gifts in default following special powers or general testamentary powers. The sparse authority indicates that the doctrine does apply to these gifts in default,³³⁷ the rationale being that the donee's refusal to exercise his power amounts, in effect, to an appointment to the takers in default, thus invoking the second look.³³⁸ For gifts in default following general powers to appoint

333. The will provided:

The part or parts of this estate held for the benefit of any issue, *per stirpes*, . . . shall upon the beneficiary of his or her trust reaching the age of 25 be divided into two parts. . . . In the event that any of my issue shall die before reaching the age of 25 or intestate after reaching such age

Id. at 460-61, 46 S.E.2d at 106. The court did not discuss why the bequest was contingent.

334. Leach, *Perpetuities: The Nutshell Revisited*, 78 HARV. L. REV. 973, 992 (1965).

335. RESTATEMENT OF PROPERTY § 392, Comment a (1944); 3 L. SIMES & A. SMITH, *supra* note 5, § 1274.

336. Even if William's children had been less than four years old at his death, the gift would have been good if his two children had been born before *T*'s death (actually they were not). The children themselves would then have been lives in being at the creation of the interest and would have attained age 25, if at all, within their own lives.

337. 3 L. SIMES & A. SMITH, *supra* note 5, § 1276.

338. *Id.* Notwithstanding that the traditional conception of a gift in default to an unascertained person is that the gift is immediately vested subject to divestiture upon later exercise of the power by the donee. RESTATEMENT OF PROPERTY § 276 (1940).

by deed, the doctrine is not necessary. The validity of the gift is measured from the date of nonexercise of the power (usually the donee's death)³³⁹ since the property was not tied up in the donee's lifetime (the donee having a general power).³⁴⁰ In effect, the nonexercise is an appointment to the takers in default, and the clock starts to run on general powers by deed at the date of exercise.³⁴¹

In addition to indicating that the validity of interests created by exercise of a general testamentary power is measured from the date of creation of the power, but with the help of a second look when needed, Case 24 involves the validity of a power itself. In this respect it is analogous to Case 22. The question is whether the special power of appointment over the remaining one-half of the trust fund given to William's children is remote. It is. Since the special power was created by exercise of William's general testamentary power, William's appointment has to be read back into *T*'s will. Thus treated, it gives a special power to William's children, persons unborn at *T*'s death, and is void.³⁴² In effect it is a special power created by *T*, capable of being exercised beyond the period of perpetuities.

The special power in Case 24 was held remote, but not for the reason just discussed. Rather, the court struck the entire gift of the remaining one-half of the fund, including the life estate, the special power, and the gift in default, on the theory that William had created a trust of the remaining one-half capable of lasting beyond the period of the Rule, regardless of when vesting must occur. The question whether the Rule relates to the duration of trusts as well as to remoteness of vesting is discussed in section V. For present purposes, suffice it to say that the court was correct in concluding that the power was bad, although for a reason not accepted by most courts.

Case 24 raises at least four other powers issues, none of them discussed by the court.³⁴³ Because these issues often accompany perpetuities cases, and because of the current importance of powers to draftsmen, they will be discussed here. These issues involve: creation of further trusts, powers, and future interests; capture; marshalling; and the reach of the gift in default. First, William exercised his power not by appointing absolute interests but by creating a further trust, a life

339. 3 L. SIMES & A. SMITH, *supra* note 5, § 1252.

340. *Id.* §§ 1251, 1274.

341. See text accompanying note 314 *supra*.

342. Leach, *supra* note 29, at 652.

343. One may only speculate on the reasons for inattention to these issues. It may have been a failure of advocacy by counsel.

estate and remainder, and a special power. May the donee of a power create further trusts, powers and future interests? The answer may depend on the nature of the power.³⁴⁴ In Case 24, since the power was general (although testamentary), the donee could have appointed to his own estate for all purposes, so William's execution was within the scope of the power. The conception of the power as property controls here; for special powers the scope of the donee's execution is sometimes more limited.³⁴⁵

Second, did William make an implied appointment of the remaining one-half of the fund to his own estate, that is, did he "capture" the property for his own estate? Case 24 held that, William's appointment being a violation of the Rule, the property passed pursuant to the gift in default. It was certainly open to argument, however, that William in effect said, "I make an express appointment as here indicated, but whether that is valid or not, I appoint the property to my own estate."³⁴⁶ Certainly two of the classic capture factors, either of which usually is sufficient to show such an intention, were present. William "blended" the appointive assets with his own property; he disposed of all owned and appointed property as a unit, making no distinction between the sources.³⁴⁷ Further, the appointment was made in trust; in effect he essayed a two-step transaction: a valid appointment of the legal title in trust and an invalid appointment of the equitable title out, creating a resulting trust in favor of his own estate.³⁴⁸ Although this trust factor is sometimes criticized as irrelevant to capture, usually it is persuasive.³⁴⁹ Note, too, that William may have regarded himself as the owner of the appointive assets, since he had a life estate plus a general power of appointment over them. In sum, the court failed to

344. 2 L. SIMES & A. SMITH, *supra* note 5, §§ 976-977.

345. *Id.* Leach and Logan suggest the following clause:

In the exercise of any power of appointment created by this will, unless the contrary is stated, the donee of such power may appoint life estates to one or more objects of the power with remainders to others, appoint to grandchildren or more remote issue even though the parents of such appointees are living, impose lawful conditions upon any appointment provided no one other than an object of the power is benefited thereby, impose lawful spendthrift restrictions upon any appointment, make appointments outright to an object or in trust for the object, create in any object a general power of appointment or a special power to appoint among objects of the original power, appoint by a will executed before my death. These powers of the donee of a power of appointment are in addition to, and not in restriction of, power he would otherwise have.

W.B. LEACH & J. LOGAN, *supra* note 18, at 976.

346. 2 L. SIMES & A. SMITH, *supra* note 5, § 974. The capture doctrine is limited to general powers. If the power were special, by definition the donee could not appoint to his estate.

347. *Id.* at 433.

348. *Id.* at 432.

349. *Id.* at 432-33.

notice strong indications of an intent to make an implied appointment to William's estate.

The reader may object, however, that capture would be nonsensical, since it would bring the property into William's estate, only to violate the Rule again. Not so. The result of capture likely would be that the appointive assets would pass as intestate property to William's heirs (his two children) under the statute of descent. As a third choice, the court might have applied the doctrine of marshalling to save William's entire plan. Marshalling simply refers to the allocation of owned and appointed property to the various provisions of the will so that maximum effectiveness is given to the testator's plan (which he must have intended).³⁵⁰ In Case 24, the appointive assets could have been allocated to satisfy the first half of the gift; there would be no perpetuities violation because the gift would vest, if at all, within fifteen years of William's death. William's own assets could have been allocated to the remaining half of the gift; there would be no perpetuities violation (whether remote vesting or trust duration) because the clock would not start running until William's death when his children perforce were lives in being. Of course, one cannot know the exact result of marshalling without knowing the values of the respective funds, and the opinion states no sums. Nevertheless, the court overlooked a useful device for carrying out William's intention.

Finally, however, it might be objected that the capture-marshalling line of argument is moot, because the donor, *T*, provided for a gift in default in the event of an invalid appointment by William. There are two answers to this objection. First, capture is a question of the donee's intention, not the donor's; it is unlikely that the intention to capture would be affected by the presence or absence of a gift in default.³⁵¹ Second, the donor's gift in default was made upon the condition, "Should my son die intestate." William did not die intestate. His will was properly executed and attested, notwithstanding a particular disposition in it violated the Rule Against Perpetuities. The court reasoned, however, that since William's appointment of the remaining half violated the Rule, he died intestate with respect to the fund. This argument assumes the conclusion that there was no capture because, if there were capture, William made a testamentary appointment to his own estate. And, of course, William did die at least partially testate.

Whatever the merits of the court's argument, the drafting moral is

350. 6 ALP, *supra* note 22, § 24.8, at 32.

351. 2 L. SIMES & A. SMITH, *supra* note 5, § 974, at 434.

clear: the gift in default should anticipate possible violation of the Rule by the donee and clearly bring the property under the gift in default, if the donor so desires.³⁵² The result of passing the property under *T*'s gift in default was not bad; the estate went to William's children, although free of trust. Nevertheless, by a capture-marshalling rationale, the court might have fully accomplished William's plan.³⁵³

To summarize, the small amount of precedent for powers in North Carolina indicates that special powers are remote if they are capable of being exercised beyond the period of the Rule (with the clock starting at the creation of the power). Interests created by exercise of special powers are judged from the creation of the power, although the second look doctrine allows one to take into account facts existing at the time of exercise. General testamentary powers are treated like special powers.

V. THE DURATION OF TRUSTS

The gospel according to Gray ordains that the Rule Against Perpetuities is a rule against remoteness of vesting; it is not a rule against interests that last too long. Thus, according to Gray,³⁵⁴ a perpetual trust to pay the income to *A* and his heirs does not violate the Rule.³⁵⁵

An occasional heresy is heard, however, which Gray ascribes to a failure to differentiate the rule against remoteness (perpetuities) from the rules disallowing restraints on alienation. Both have the "same ultimate end [forwarding the circulation of property], but they serve that end by different means."³⁵⁶ Some of the heresy is proclaimed in fairly

352. See also *In re Price's Trust*, 4 Misc. 2d 1026, 156 N.Y.S.2d 901 (Sup. Ct. 1956); 5 ALP, *supra* note 22, § 23.61; 22 S. CAL. L. REV. 270, 276 (1949). The Wachovia Will Manual uses the language "[i]f this general power of appointment shall not be effectually exercised." WACHOVIA BANK & TRUST, NORTH CAROLINA WILL MANUAL SERVICE IX-14 (N. Wiggins ed. 1977). The NCNB Will and Trust Manual uses "in default of appointment." NORTH CAROLINA NATIONAL BANK, WILL AND TRUST MANUAL F-3 (1978). Since Case 24 seems eager to give effect to the gift over, explicit language may not be necessary, and indeed, clear-cut language is not easy to find. If one said, "If this power is not validly exercised," there still is room to argue that capture is a valid exercise by implication.

353. The court's attitude is somewhat at odds with its view on construction to avoid invalidity. See section II.B.3.c. *supra*.

354. J.C. GRAY, *supra* note 22, §§ 3, 235-249.9.

355. *Id.* §§ 3, 235-236. If the words "and his heirs" are words of limitation, *A* immediately takes an equitable fee; an equitable fee is no more objectionable because it may last forever than is a devise of a legal fee simple. If the words "and his heirs" are ones of purchase, *A*'s heirs take a vested interest upon *A*'s death. *Id.* §§ 235-236. (This assumes an American meaning of heirs rather than an English meaning of indefinite takers from generation to generation. See Webster, *supra* note 8, § 27.) See also RESTATEMENT OF PROPERTY § 381 (1944).

356. J.C. GRAY, *supra* note 22, § 2.1.

recent North Carolina cases.

*Case 25.*³⁵⁷ See Case 24 in section IV on powers of appointment.

*Case 26.*³⁵⁸ *T* devised his real estate to his son-in-law, J.H. Thompson, to hold in trust for *T*'s daughter Vivian for her life and in the event of her death to rent the property and apply the rents, after the payment of taxes, for the "support, sustenance, education and benefit" of Vivian's surviving children. Vivian had two children at *T*'s death and two more were born to her later. She died survived by the four children. *Held*, the trust was void because it might have lasted beyond lives in being plus twenty-one years.

These two cases, decided in 1948 and 1949, indicate that the Rule applies to trust duration as well as to vesting and that a trust that may last beyond the period of the Rule is void. From the standpoint of the precedent cited in support of their holdings, the two cases are not strong;³⁵⁹ from the standpoint of the rationale enunciated, the cases are

357. *American Trust Co. v. Williamson*, 228 N.C. 458, 46 S.E.2d 104 (1948), noted in 27 N.C.L. REV. 158 (1948).

358. *Mercer v. Mercer*, 230 N.C. 101, 52 S.E.2d 229 (1949), noted in 48 MICH. L. REV. 236 (1949).

359. An earlier case, *Springs v. Hopkins*, 171 N.C. 486, 88 S.E. 774 (1916), was cited in both cases as authority for the proposition that the Rule Against Perpetuities limits the duration of private trusts. *Springs* does not support that proposition. Simplified, the case involved a deed of real property to the wife of the grantor's son, William, for life, then in trust for William's children until the youngest attained 21, then to the use of William's children and their heirs forever, and in the event of death of any child without issue, his share to vest in the surviving children and their heirs. The court found that the interest in William's children was vested subject to divestiture upon death without issue (at any time, not just before William's death) and that there was no violation of the Rule Against Perpetuities:

It was argued that our construction of the limitation would violate the rule against perpetuities. But we do not think so, for the rule, as its very language implies, refers solely to the vesting of estates, and does not concern itself with their possession or enjoyment, nor does it require that interests should end within specified limits.

Id. at 494, 88 S.E. at 778. Thus, the court uses classic remoteness of vesting language, expressly rejecting any concern with possession or enjoyment. It is, however, dictum, because the trust in *Springs* did not last beyond the period of the Rule; the court held that the trust became passive, and was executed by the Statute of Uses, when the youngest child attained 21. *Id.* at 491, 88 S.E. at 776. This was necessarily within the perpetuities period because all of William's children would necessarily reach age 21 within 21 years after the death of William, a life in being.

The gift over upon death of a child without issue appears to be remote (although not so held), since a child of William could have died without issue more than 21 years after William's death. The child could not be a measuring life, since more children could have been born to William after the delivery of the deed or the grantor's death. (Normally the clock starts upon delivery of a deed, but the grantor retained a power to revoke, *id.* at 488-89, 88 S.E. at 775, so the clock did not start until the grantor's death.) As to the effect of invalidity of this condition subsequent on prior interests, see section II.B.2.b. *supra*.

Case 25 also cited *Billingsley v. Bradley*, 166 Md. 412, 171 A. 351 (1934), and *Gray*, *Ameri-*

not persuasive;³⁶⁰ and from the standpoint of the facts of the cases, the decisions are somewhat equivocal.³⁶¹ This is not to suggest that the cases necessarily were incorrectly decided, but merely to note certain weaknesses in them as precedents.³⁶²

The trust duration conception of the Rule apparently was short-lived:

*Case 27.*³⁶³ T devised and bequeathed the residue of her estate to her sister Margaret for life, and "after the death of

can Trust Co. v. Williamson, 228 N.C. 458, 462-63, 46 S.E.2d 104, 107-08 (1948). For a time, Maryland courts took the view that the Rule applied to trust duration, but later overruled those decisions. See 48 MICH. L. REV. 236 n.6 (1949). Gray does not support the court's conclusion in Case 25.

Case 26 cited *Billingsley v. Bradley*, *Springs v. Hopkins* and Case 25. *Mercer v. Mercer*, 230 N.C. 101, 103, 52 S.E.2d 229, 230 (1949).

360. Case 25 simply announces its rule without stating a rationale. Case 26 tries to find a rationale but gets the two ideas of remote vesting and suspension of alienation hopelessly intertwined:

Much has been written on the subject of perpetuities. Repetition here would serve no useful purpose. Suffice it to say that the common law rule against perpetuities is recognized and enforced in this State.

This rule is not one of construction but a positive mandate of law to be obeyed irrespective of the question of intention. . . . Its primary purpose is to restrict the permissible creation of future interests and prevent undue restraint upon or suspension of the right of alienation. Whenever the future interest takes effect, or the right of alienation is suspended beyond the period stipulated in the rule, it is violative thereof. . . .

While there are some cases *contra*, the great preponderance of authorities in the United States is to the effect that the rule applies to private trusts. . . . The decisions of this Court are in line with the majority view. "A trust for private purposes must terminate within a life or lives in being and twenty-one years and ten lunar months thereafter." . . .

The rule is thus applied for the reason a trust violative of the rule in duration effects an undue postponement of the direct enjoyment of the property and works an unreasonable restraint on alienation.

If the period of the trust is too long, the court does not reduce the limitation to lives in being and twenty-one years, but declares the whole trust invalid.

Mercer v. Mercer, 230 N.C. 101, 103-04, 52 S.E.2d 230, 230 (1949) (quoting *American Trust Co. v. Williamson*, 228 N.C. 458, 463, 46 S.E.2d 104, 108 (1948)) (citations omitted).

Note, too, the court's incorrect statement that the gift would have been good if Vivian had died without issue surviving her. *Id.* at 104, 52 S.E. 2d at 230. Under the traditional rule, there is no "wait and see"; the validity of interests is judged from the testator's death.

361. In both cases at least some of the interests struck down as lasting too long would have been remote anyway under the more limited Gray remoteness of vesting approach. In Case 25 the special power of appointment and the gift in default vested remotely, and in Case 26 the trustee's power to distribute for support, sustenance, education and benefit may have been a remote special power, unless the power was confined to J.H. Thompson, making him the measuring life. Also in Case 26, there was no provision for final termination of the trust. If title vested in the heirs of the grandchildren, the heirs' interests were too remote. (The court's statement that, if title vested in the heirs of the testator the gift was bad, appears incorrect under the Gray approach: the testator's heirs would be fixed at his death, even though possession of their interest was postponed to the death of the grandchildren.)

362. The question whether the cases are sound from the standpoint of perpetuities policies is discussed in the text at the end of this section.

363. *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 68 S.E.2d 831 (1952).

. . . Margaret, . . . or in the event she shall predecease me," to a bank and two individuals in trust.³⁶⁴ The trustees were directed: (1) to collect income and to pay taxes; (2) to give financial assistance to a named grandnephew and grandniece if either should decide to attend college;³⁶⁵ (3) to pay certain sums to named beneficiaries; and (4) to divide the net income quarterly and pay it to named nephews, nieces, a grandnephew and a grandniece in designated proportions.³⁶⁶ The trust "shall continue for a period of twenty-five years from the date of filing this, my last will and testament for probate in the office of the Clerk . . . or from the date of the death of my sister, Margaret . . . whichever may be the later date,"³⁶⁷ and then the trust shall terminate and the trustees shall within one year thereafter fully account and deliver all of the trust property in fee to the same nephews, nieces, grandnephew and grandniece who were to receive the income, and in the same proportions. The trustees were given power to sell, lease, invest and reinvest.³⁶⁸ Held, the Rule Against Perpetuities was not violated. The interests of the nieces, nephews, grandnephew and grandniece vested immediately upon *T*'s death, subject only to postponed enjoyment.³⁶⁹

Case 27 expressly rejected the language in Cases 25 and 26, and adopted instead the usual Gray approach:

The plaintiffs rely on what is said in [*American*] *Trust Co. v. Williamson* . . . and *Mercer v. Mercer* . . . respecting the rule against perpetuities as applied to private trusts. Perhaps the language used in the *Williamson* case and adopted in the *Mercer* case is not as full and complete as it might have been. In any event, the language used must be interpreted in the light of the facts in those cases and the

364. *Id.* at 738-39, 68 S.E.2d at 833. Any remote powers in the trustees could not be saved by treating the powers as personal to the trustees, and thereby using the trustees as measuring lives, because one of the trustees was a bank.

365. This power is not possibly remote, because it would necessarily be exercised, if at all, within the lives of the named grandnephew and grandniece.

366. The court did not consider the possible application of the widely-criticized "divide and pay over rule," which maintains that language such as "divide and pay over" implies a condition precedent that the beneficiary be alive at the time of payment in order to take.

367. *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 739, 68 S.E.2d 831, 833 (1952). As to whether the equitable interests were remote because subject to a condition precedent that *T*'s will be filed, an event which might not occur within the period of the Rule, see section II. *B.3.b. supra*.

368. *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 739, 68 S.E.2d 831, 833 (1952); see text accompanying notes 321 & 322 *supra*.

369. *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 743, 68 S.E.2d 831, 835 (1952). The trial court had held the trust invalid.

authorities cited. In the *Williamson* case there was a power of appointment which, if exercised by the trustee, would be violative of the rule against perpetuities, and in the *Mercer* case there was a future interest which might not vest within the time prescribed by the rule.

The rule may not be evaded by the creation of a private trust. It "applies to the time when the legal interest will vest in the trustees, as well as to the time when the equitable or beneficial interest will vest in the beneficiaries." . . . The question is not the length of the trust but whether title vested within the required time. . . .

"Courts and writers sometimes state in a rather loose fashion that every express private trust must be limited in duration to a period not longer than lives in being when the trust starts and twenty-one years thereafter . . . This is incorrect, except in a very few states where trusts in general, or certain trusts, have been limited in their duration by statute." . . .³⁷⁰

"An interest is not obnoxious to the Rule against Perpetuities if it begins within lives in being and twenty-one years, although it may end beyond them. If it were otherwise, all fee-simple estates would be bad. The law is the same with lesser estates."³⁷¹

Case 27 has been followed in three subsequent cases.³⁷² Its view has been held retroactive.³⁷³ However, the following case is puzzling.

*Case 28.*³⁷⁴ *T* died in 1956 leaving a will which provided,

Therefore it is my will that my half of my & her (wife) estate be given to my three children—Judy Greer Honeycutt, Nancy Ann Honeycutt, and William Carson Honeycutt, to share & share alike. After all taxes or other debts have been settled.³⁷⁵

It is my will that said property be held in trust by my wife & my friend Kester Walton, Atty. for said children until & when the year 1980—then $\frac{1}{3}$ of residue be paid to my children or his or

370. *Id.* at 743, 68 S.E.2d at 836 (quoting G. BOGERT, *supra* note 158, § 218)(footnote added).

371. *Id.* (quoting J.C. GRAY, *supra* note 22, § 232). The interests are vested, not contingent, apparently because of the gift of intermediate income. *Accord*, *Carter v. Kempton*, 233 N.C. 1, 62 S.E.2d 713 (1950). The power in the trustees to use income for other purposes (college education of the grandnephew and grandniece) did not make the income beneficiaries' interests remote; rather, the ultimate beneficiaries had interests that were vested subject to divestiture to meet the college needs. *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 742-43, 68 S.E.2d 831, 835-36 (1952).

Judge Barnhill wrote the opinions in Cases 26 and 27.

372. *Poindexter v. Wachovia Bank & Trust Co.*, 258 N.C. 371, 128 S.E.2d 867 (1963); *Farnan v. First Union Nat'l Bank*, 263 N.C. 106, 139 S.E.2d 14 (1964); *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 241 S.E.2d 397, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978).

373. *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 352, 241 S.E.2d 397, 401, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978).

374. *Finch v. Honeycutt*, 246 N.C. 91, 97 S.E.2d 478 (1957), *noted in* 36 N.C.L. REV. 467, 469 (1958).

375. As to whether the postponement until payment of debts and taxes creates any perpetuities violation, see section II.B.3.b. *supra*.

her children if any child of mine should die before reaching the year 1980. Trustee may have two years to pay said $\frac{1}{3}$ of estate to said children or their heirs— $\frac{1}{2}$ of balance of residue estate shall be distributed in the year 1992 on the same conditions as outlined above. The balance of the estate is to be distributed in the year 2005 on the same conditions as outlined above.

If any child becomes disabled mentally or habits causing irresponsibility—a spendthrift—without heirs of his or her own or adopted children. Then his or her part of the estate shall be withheld at any one of the periods of distribution—and given to him or her as needed.

If any of my issue have heirs or adopted children, and become disabled mentally or by habits—then such children shall take the benefits along with its father or mother.

It is my desire that my Trustees will look after my childrens educational, moral and religious interests as well as their money or material interests.³⁷⁶

T was survived by three minor children, ages seven, three and one. *Held*, the trust did not violate the Rule Against Perpetuities.

The rationale of the court was not altogether clear. The court first used the standard rationale that the equitable interests vested on the death of *T*,³⁷⁷ subject only to postponed enjoyment, but then added,

376. *Finch v. Honeycutt*, 246 N.C. 91, 92-93, 97 S.E.2d 478, 480 (1957). In addition to the perpetuities challenge, plaintiffs argued that the trust was a passive one executed by the Statute of Uses. The court held that the trustee's duty to look after the childrens' interests made the trust active.

377. The court stated:

The contention [that the trust violates the Rule] is not well founded here. For "it is generally held, nothing else appearing in the will to the contrary, that where an estate is devised to a trustee in an active trust for the sole benefit of persons named as beneficiaries, with direction to divide up and deliver the estate at a stated time, this will have the effect of vesting the interest immediately on the death of the testator. The intervention of the estate of the trustee will not have the effect of postponing the gift itself, but only its enjoyment." . . .

The gift in the instant case to the children vested in interest to them immediately upon the death of the testator, although the full enjoyment was postponed to later dates. When these conditions exist, a trust does not violate the Rule against Perpetuities.

Id. at 100, 97 S.E.2d at 485 (quoting *Coddington v. Stone*, 217 N.C. 714, 719, 9 S.E.2d 420, 423 (1940)).

Arguably, the interest in *T*'s children was not vested at his death because the trust provided for payment to *T*'s grandchildren "if any child of mine should die before reaching the year 1980." Of course, this provision could be treated as a condition subsequent rather than a condition precedent. Even if it imposes a condition precedent, the gift to *T*'s children still appears to be good, because the children would take, if at all, within their own lives. The gift over to *T*'s grandchildren appears to be good, because it would vest at the death of *T*'s children, subject only to postponed enjoyment (assuming there is no implied condition precedent of survivorship to the time of distribution). Query: What disposition if a child of *T* died before 1980 without leaving children?

Even though the postponements here ultimately invade the Twenty-first Century, reference to the ages of the children indicates that the postponements are within the life or lives of the beneficiaries in being and twenty-one years and ten lunar months thereafter, the limitation of the Rule against Perpetuities.³⁷⁸

A commentator suggested that this passage might have revived the line of reasoning in *American Trust Co. v. Williamson*³⁷⁹ (Case 25) and *Mercer v. Mercer*³⁸⁰ (Case 26),³⁸¹ but the court quickly put the damper on that suggestion:

*Case 29.*³⁸² *T* died in 1952 leaving a will as follows:

First, . . . I trust all of the balance of my property which I shall own at the time of my death to Wachovia Bank and Trust Company to be held in trust for my son William Harvey Poindexter and be paid out to him in the manner herein after stated.

2nd. To pay to my said son for his use all of the net income from my estate for the purpose of giving him proper support and if he should get disable to work and if the income is not sufficient, I direct that so much of the principal be used as may be deemed wise to properly support him.

Three (3) Personal property to be owned and used by him as long as he should live and by his issue also. Then to go to my brothers and sisters the same as the other property.

Fourth, if however my son should die leaving issue then his issue shall receive the income from my estate as he did. But if he should leave no issue then I will and direct that what remains of my property . . . be divided between my brothers and sisters that is living and have led a sober and good life in every way.³⁸³

T was survived by William and his two minor children. *Held*, William took a life estate, not a fee, with remainder to his

378. *Id.* at 100, 97 S.E.2d at 485 (citing *American Trust Co. v. Williamson*, 228 N.C. 458, 46 S.E.2d 104 (1948)).

379. 228 N.C. 458, 46 S.E.2d 104 (1948).

380. 230 N.C. 101, 52 S.E.2d 299 (1949).

381. *Survey of North Carolina Case Law*, 36 N.C.L. REV. 379, 467-68 (1958):

The significance of this language is not clear. However, it would seem to imply that under a different factual situation the Court might strike down an otherwise valid trust because full enjoyment of the fee is postponed for a period which might exceed that of the Rule Against Perpetuities. The Court seems to be saying that because of the youth of the children it has concluded that the distributions will probably be made within their normal life spans and twenty-one years thereafter. Unanswered is the question of what the Court would have said and done had the beneficiaries been so much older that it appeared unlikely that the distributions would be made within their lives and twenty-one years.

The eldest child would have been 56 at the time of the last distribution.

382. *Poindexter v. Wachovia Bank & Trust Co.*, 258 N.C. 371, 128 S.E.2d 867 (1963).

383. *Id.* at 374, 128 S.E.2d at 870.

issue living at his death.³⁸⁴ The trust terminated at the death of William's issue who were living at his death. As so construed, the trust did not violate the Rule Against Perpetuities.

The opinion in Case 29 squarely rejected the *Williamson/Mercer* approach and said that *Finch v. Honeycutt*³⁸⁵ (Case 28) was not in conflict with *McQueen v. Branch Banking & Trust Co.*³⁸⁶ (Case 27).³⁸⁷ The courts have continued to adhere to the Case 29 approach:

*Case 30.*³⁸⁸ *T* left the residue of his estate to a bank in trust to pay the income to named nieces and nephews for life, and upon the death of the last niece or nephew to hold the property in trust for twenty years, accumulating the income for the benefit of a church:

At the expiration of said twenty years the Trustee shall as soon as practicable after the . . . Church . . . has in writing expressed its willingness to accept and use the fund for the purpose hereinafter stated, pay and distribute, free of trust, to the . . . Church . . . upon the following stated conditions: The trust

384. The court found sufficient indications of *T*'s intention to use "issue" in the sense of lineal descendants living at William's death, not in the technical English sense of an indefinite succession of lineal descendants. If used in the latter sense, the Rule would have been violated. *Id.* at 377, 128 S.E.2d at 872.

385. 246 N.C. 91, 97 S.E.2d 478 (1957).

386. 234 N.C. 737, 68 S.E.2d 831 (1952).

387. In Case 29 the court stated:

Plaintiff also insists that the trust itself offends the rule against perpetuities in that it will not in all events terminate within a life in being at the death of testatrix plus twenty-one years and ten lunar months. It is true that there is a possibility that the trust will extend beyond such period. It was formerly the law in this jurisdiction that a trust for private purposes must *terminate* within a life or lives in being and twenty-one years and ten lunar months thereafter. *Mercer v. Mercer* . . . ; *Trust Co. v. Williamson* . . . ; *Springs v. Hopkins* . . . But the principle is now established that the rule against perpetuities "does not relate to and is not concerned with the postponement of the full enjoyment of a vested estate. The time of the vesting of title is its sole subject matter. . . . The question is not the length of the trust but whether title vested within the required time." *Finch v. Honeycutt* . . . is not in conflict with the *McQueen* decision as has been suggested [36 N.C.L. REV. 379, 467]. In the case at bar the title vests in the beneficiaries in any event no later than ten lunar months following the death of William Harvey Poindexter, a life in being at the death of testatrix. The trust will terminate at the death of the issue of William who are living or *en ventre sa mere* at his death. The equitable and legal titles of said issue of William will not merge. In a passive trust the legal and equitable titles are merged in the beneficiary by virtue of the statute of uses. . . . But if the trust is active they do not merge. . . . The trust created by Mrs. Poindexter is an active trust and it does not violate the rule against perpetuities. It will continue until the purpose for which it was created ceases.

258 N.C. at 378-79, 128 S.E.2d at 873 (quoting *McQueen v. Branch Banking & Trust Co.*, 234 N.C. 737, 743, 68 S.E.2d 831, 836 (1952))(citations omitted).

To quibble a bit, the holding in *Finch* certainly is not in conflict with *McQueen*. The question is, what was the rationale in *Finch* and what did its curious paragraph citing *Williams* mean? Why was *Finch* not in conflict with *McQueen*?

388. *Farnan v. First Union Nat'l Bank*, 263 N.C. 106, 139 S.E.2d 14 (1964).

fund shall be matched . . . and the total amount . . . shall be used to construct . . . a Church

If, however, the . . . Church . . . at any time within one year after the expiration of the twenty year period . . . in writing declines to accept the said gift upon the said terms, or if at the end of said one year, it has not affirmatively elected to accept . . . the Trustee shall pay and distribute the said trust fund, free of trust, to certain charitable institutions³⁸⁹

Held, the trust did not violate the Rule. "That the trustee is allowed indefinite additional time ('as soon as practicable') to pay and distribute the fund to the church after acceptance, does not prevent the vesting of title upon acceptance."³⁹⁰

*Case 31.*³⁹¹ *T* left the residue of his estate in trust, to divide the annual income into twenty equal shares, paying shares to various named relatives (all of whom were lives in being) and sixteen shares to be divided among named and unnamed great nieces and great nephews:

(i) The income from the sixteen shares shall be equally divided among my great nieces and nephews, now twelve (12) in number, and those who hereafter may be born within twenty-one (21) years after my death, they to share equally with the others.

(j) The share of income allotted to each great-niece and great-nephew shall be paid to the child's guardian, if there be such, and disbursed by him or her for the benefit of the child. The object of this provision is to simplify the handling of income, which will be small.³⁹²

The will provided that the trust was to continue in effect "for, and during the joint and several lives of" his surviving brothers and sisters, listed by name, his eleven nieces and great nephews, then in being, listed by name, with the name of the parent of each of the great nieces and great nephews. It further provided that the trust should continue in effect

for and during the joint and several lives of any other nieces or nephews or great nieces or great nephews born prior to, and alive at the time of my death, and until the death of the last survivor of my brothers and sister, and the last survivor of my

389. *Id.* at 108, 139 S.E.2d at 16.

390. *Id.* at 110, 139 S.E.2d at 18.

391. *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 241 S.E.2d 397, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978). Most of the facts are stated in an earlier opinion involving different issues arising from the same will. *Wachovia Bank & Trust Co. v. Andrews*, 264 N.C. 531, 142 S.E.2d 182 (1965).

392. *Wachovia Bank & Trust Co. v. Andrews*, 264 N.C. 531, 533, 142 S.E.2d 182, 184 (1965).

nieces and nephews, and the last survivor of my great nieces and nephews (alive at my death) as just above referred to, and no longer.³⁹³

The trustee had a power to sell and reinvest. *Held*, all interests must vest within the permissible period,³⁹⁴ and even if the trust could extend beyond the period of the rule,³⁹⁵ duration of the trust was not controlling.³⁹⁶

In sum the recent cases both state and hold that the Rule is concerned with vesting, not trust duration. Cases 25 and 26 seem to be dead. Should one mourn their demise or dance on their grave?³⁹⁷

Modest celebration appears to be in order, after one examines the question of trust duration in light of the policies behind the Rule. (The cases, alas, do not approach the question from this angle, and the early confusion of Cases 25 and 26 may reflect, in part, the difficulty of introducing the rule against remoteness of vesting into a situation in which it seems a foreigner.) The principal policies served by the Rule are furthering alienability and limiting dead hand control.³⁹⁸ Viewed from the perspective of alienability, perpetual trusts do not pose a real danger in North Carolina. The trustee customarily is given an express power to sell his legal interest, and when one is not expressly given, a court of equity will grant a power of sale in the event of emergency.³⁹⁹ In the absence of a spendthrift clause, the beneficiary's equitable interest apparently is alienable; although there is little precedent, North

393. *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 349, 241 S.E.2d 397, 399, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978).

394. It is not clear from the opinion that all interests vested within the period of the Rule.

395. It was argued that duration could be measured by an after born niece or nephew. *Wing v. Wachovia Bank & Trust Co.*, 35 N.C. App. 346, 351, 241 S.E.2d 397, 401, *cert. denied*, 295 N.C. 95, 244 S.E.2d 263 (1978). Perhaps the argument (unstated in the opinion) was that "surviving" meant an indefinite line of survivors, or that the class of nieces and nephews was not confined to those living at T's death.

396. The court stated:

We are aware that *Mercer v. Mercer* . . . held that a trust must terminate within the permissible period. In *McQueen v. Trust Co.* . . . the Court distinguished *Mercer* and in *Poindexter v. Trust Co.*, we believe that *Mercer* was overruled. Plaintiffs contend that since *Mercer* was the law at a time that the trust under Mr. Andrews' will was being administered, we cannot now rule that the limitation under his will does not violate the rule. We do not accept this argument. Nowhere in either the *McQueen* or *Poindexter* cases do we read that they were to have only prospective effect. We believe they declare the common law of this State as to limitations in instruments now in effect.

Id. at 351-52, 241 S.E.2d 401.

397. See generally T. BERGIN & P. HASKELL, *supra* note 22, at 225; G. BOGERT, *supra* note 158, § 218; 5 R. POWELL, *supra* note 22, ¶ 772; I A. SCOTT, TRUSTS § 62.10 (3d ed. 1967); RESTATEMENT OF PROPERTY § 381 (1944).

398. See note 491 *infra*.

399. See notes 496-97 *infra*.

Carolina probably would not follow the *Claflin*⁴⁰⁰ doctrine that prevents trust termination when termination would defeat a material purpose of the settlor.⁴⁰¹ Spendthrift trusts are not a significant consideration, because their limited statutory validation has been reduced to triviality by the effects of inflation.⁴⁰² In sum, the beneficiary's interest must vest within the period of the Rule and, once vested, it will be alienable. Since trustee and beneficiary may both sell, alienation is not unduly restrained. Even though the existence of the trust,⁴⁰³ or the fact of multiple beneficiaries,⁴⁰⁴ may make alienability less likely, that does not seem a sufficient justification to invalidate the trust.⁴⁰⁵ And, looked at in terms of dead hand control, the trustee's and beneficiary's power to sell within the period of the Rule, ending forever the settlor's control, justifies the exemption of trust duration from the Rule.

The law elsewhere is in a formative state. In states recognizing indestructible or *Claflin* trusts, there may be a rule limiting trust duration to the period of the Rule Against Perpetuities.⁴⁰⁶ The best approach would be not to regard this as a question of perpetuities, so that the issue will be joined instead at the fundamental level of restraints on alienation. If an indestructible trust is limited to the perpetuities period, the effect of creating an overlong trust is unclear; the trust may be destructible by the beneficiaries after the expiration of the period of the Rule, or it may be destructible at any time,⁴⁰⁷ or it may (as in Cases 25 and 26) be destroyed by the court *ab initio*, a result that is harsh but nevertheless consistent with the usual perpetuities approach.⁴⁰⁸

As a matter of good drafting, it is advisable not to run the risk of

400. *Claflin v. Claflin*, 149 Mass. 19, 20 N.E. 454 (1889).

401. There is no case directly on point. For intimations, see *Smyth v. McKissick*, 222 N.C. 644, 24 S.E.2d 621 (1943); *Patrick v. Beatty*, 202 N.C. 454, 163 S.E. 572 (1932); *Mizell v. Bazemore*, 194 N.C. 324, 129 S.E. 453 (1927); *Bank of Union v. Heath Cotton Co.*, 187 N.C. 54, 121, S.E. 24 (1924); *Turnage v. Green*, 55 N.C. (2 Jones Eq.) 63 (1854); R. LEE, *NORTH CAROLINA LAW OF TRUSTS* 31-32 (6th ed. 1973). But see *Fowler & Lee v. Webster*, 173 N.C. 442, 92 S.E. 157 (1917).

402. N.C. GEN. STAT. § 41-9 (1976) validates spendthrift trusts to the extent of \$500 annual income. Although the statute does not expressly invalidate all other spendthrift trusts, it is assumed to do so. See Christopher, *Spendthrift and Other Restraints in Trusts: North Carolina*, 41 N.C.L. REV. 49, 66 (1962).

403. 3 L. SIMES & A. SMITH, *supra* note 5, § 1391.

404. I A. SCOTT, *supra* note 397, at 605.

405. 5 R. POWELL, *supra* note 22, ¶ 722[3], at 623-25. See also G. BOGERT, *supra* note 158, § 218, at 561.

406. 3 L. SIMES & A. SMITH, *supra* note 5, § 1393.

407. *Id.*

408. *Id.* at 246.

creating a trust to last beyond lives in being plus twenty-one years.⁴⁰⁹ Even though the trust may ultimately be sustained, the draftsman risks litigation. Also, he may find the trustee stripped of distributive powers on the ground that powers to pay principal or income amount to remotely exercisable special powers of appointment.⁴¹⁰ The trustee's administrative powers should not be invalid, but there is some risk involved.⁴¹¹

VI. COMMERCIAL INTERESTS

It is often said that contracts are not subject to the Rule,⁴¹² but that statement is too broad. It is often said that the Rule does not apply to present interests,⁴¹³ but that statement, too, is overbroad. Indeed, when one attempts to sort out the applications of the Rule to interests other than the traditional future interests associated with gratuitous transfers, he quickly encounters a set of seemingly contradictory holdings. In contrast to the usual perpetuities cases on gifts, wills and trusts, in which a doctrinaire application of the Rule usually results in the "correct" answer, in the commercial interest cases a logical approach based on the face of the Rule does not always yield a predictably correct result. Rather, one must look to some ad hoc reasons behind the black letter of the rule. For example:

*Case 32.*⁴¹⁴ *B* conveyed land to *C* for use as a park on certain conditions. The habendum clause limited the park to use by white persons only, and the deed further provided that should the park fail to be used by white persons only, the property should revert to *B*, his heirs or assigns; provided that as a condition precedent to the reversion, *B*, his heirs or assigns, should pay *C* or its successors the sum of \$3500. *Held*, the deed created a fee simple determinable in *C* and a possi-

409. The Wachovia form book is somewhat less cautious, providing that "no trust (other than a trust of a vested interest) . . . shall continue [beyond the period of the Rule]." WACHOVIA BANK & TRUST, *supra* note 352, at XVI-32.

410. 6 ALP, *supra* note 22, § 24.32.

411. *Id.* § 24.63.

412. *E.g.*, 5 R. POWELL, *supra* note 22, ¶ 767B.

413. *E.g.*, 6 ALP, *supra* note 22, § 24.55.

414. *Charlotte Park & Recreation Comm'n v. Barringer*, 242 N.C. 311, 88 S.E.2d 114 (1955), *cert. denied*, 350 U.S. 983 (1956). The case is noted in a number of law reviews, but most of the articles concentrate on the constitutional issue of whether judicial enforcement of the reverter clause constituted discriminatory state action in violation of the fourteenth amendment under the precedent of *Shelley v. Kraemer*, 334 U.S. 1 (1948).

bility of reverter in *B*, which possibility of reverter did not violate the Rule Against Perpetuities.

The holding in Case 32 that the possibility of reverter in *B* does not violate the Rule is difficult to explain except on historical grounds. Obviously, the property may cease to be used for a park long after any lives in being plus twenty-one years; and to label the interest as presently vested seems to ignore its fundamental nature.⁴¹⁵ Nevertheless, the holding in Case 32 follows the guiding (and probably misguided) precedent of *First Universalist Society v. Boland*,⁴¹⁶ the leading American case exempting possibilities of reverter from the Rule. Powers of termination (rights of entry)⁴¹⁷ are similarly exempt in the United States,⁴¹⁸ although there is no direct North Carolina precedent.⁴¹⁹

In Case 32 the court treated the interest in *C* as a fee simple determinable, despite plausible arguments (apparently unraised by counsel) that *C*'s interest was a fee simple absolute subject only to a covenant⁴²⁰ or a fee simple subject to a condition subsequent⁴²¹ (because *B* was required to pay \$3500 to *C* to effect a reverter). In any event, *B*'s interest was held to be good. If, instead of preserving the reverter in himself, *B* had given the property, in the event of breach of the condition, over to a third person (*D*), the interest in *D* would have been an executory interest violating the Rule.⁴²²

415. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, §§ 1238-1239; 6 ALP, *supra* note 22, § 24.62; 5 R. POWELL, *supra* note 22, ¶ 769.

416. 155 Mass. 171, 29 N.E. 524 (1892). Indeed, the opinion in Case 32 cited *First Universalist Society v. Boland*. See *Charlotte Park & Recreation Comm'n*, 242 N.C. 311, 317, 88 S.E.2d 114, 120 (1955), *cert. denied*, 350 U.S. 983 (1956).

417. For example, *O* conveys Blackacre to *A* and his heirs on condition that the property be used for a farm, and if the property ceases to be used for a farm, *O* or his heirs may reenter and repossess as of *O*'s former estate. *A* would have a fee simple subject to a condition subsequent, and *O* would have a power of termination. The difference from the fee simple determinable is that the property does not automatically revert upon breach of the condition—*O* must reenter. See generally J. WEBSTER, *REAL ESTATE LAW IN NORTH CAROLINA* §§ 35-38 (1971).

418. Powers of termination are exempt even though the requirement of a reentry makes the interest even less vested than a possibility of reverter. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1238.

419. Any North Carolina case recognizing powers of termination unlimited in duration is, indirectly, an affirmation that the interest is exempt from the Rule. For a collection of cases recognizing fees simple subject to a condition subsequent, see J. WEBSTER, *supra* note 417, §§ 37-38.

420. It is said that defeasible estates are not favored, as the law abhors forfeitures. The deed did not use the classic determinable fee language of "to *C* so long as the property is used for a park for whites only" but merely tacked the racial provision onto the deed in the habendum clause. See 6 ALP, *supra* note 22, § 24.62 n.8a (Supp. 1977); 34 N.C.L. REV. 113, 115 n.8 (1955).

421. The property could not automatically revert to *B* (the hallmark of a fee simple determinable) if, "as a condition precedent to the reversion," *B* was required to pay \$3500 to *C*. This looks like a power of termination. See 34 N.C.L. REV. 113, 115 n.18 (1955).

422. For example, *B* conveys to *C* for use as a park; provided that should the park fail to be

What result in Case 32 if, instead of creating a possibility of reverter in himself, *B* had retained an option to repurchase the land? For example, suppose that in Case 32 *B* had conveyed the land to *C* in fee simple absolute, and *C* had covenanted that if the property should cease to be used for a park for whites only, upon payment of \$3500 *C* would reconvey the property to *B*. No case exactly like this has arisen in North Carolina, but cases in other jurisdictions have invalidated *B*'s interest.⁴²³ Case 33 represents the closest North Carolina precedent:

*Case 33.*⁴²⁴ *G* and his wife sold a lot to *E*,

retaining for themselves and their heirs and assigns the right to repurchase said land when sold, the said [*E*] conveying a title for said lands, either by deed or mortgage, to any person without first giving [*G* and his wife], and their heirs and assigns, the privilege of repurchasing the same, renders this deed null and

used by white persons only, upon the payment of \$3500 by *D* or his heirs the property shall go to *D* and his heirs. *C* would have a fee simple subject to an executory interest, and *D* would have a shifting executory interest. See generally J. WEBSTER, *supra* note 417, § 39. The executory interest in *D* would be remote because the event might not occur within the period of the Rule. *E.g.*, 6 ALP, *supra* note 22, § 24.62. It is difficult to distinguish this remote executory interest in *D* from the valid possibility of reverter in *B*. *Id.*

The grantor who wishes to create a fee simple in *A* subject to a remote executory interest in *B* may, if he is cleverly advised, accomplish his desires indirectly by first creating a defeasible fee in *A*, leaving a possibility of reverter or power of termination in the grantor. He then conveys or devises that possibility of reverter or power of termination to *B*, who is regarded as owning the grantor's valid reverter interest, not a remote executory interest. This device is made possible by statutes allowing the conveyance or devise of possibilities of reverter and powers of termination, and was even effective in *Brown v. Independent Baptist Church*, 325 Mass. 645, 91 N.E.2d 922 (1950), in which the testatrix created the determinable fee in one will clause and devised the possibility of reverter in another, residuary clause. By statute in North Carolina, possibilities of reverter and powers of termination are alienable. N.C. GEN. STAT. § 39-6.3 (1976), devisable, *id.* § 31-40, and descendible, *id.* § 29-2(2). For some time, it was held in North Carolina that powers of termination were not alienable or devisable if the condition was unbroken. The statutes now state that powers of termination are transferable, "whether any such condition has or has not been broken" at the time of transfer. *Id.* § 31-40; see *id.* § 39-6.3. There is no such statement in the statute on descendibility, § 29-2(2), but the omission should not be a problem because rights of entry were inheritable at common law even when the condition was unbroken. See generally McCall, *supra* note 1; Webster, *The Quest for Clear Land Titles—Whither Possibilities of Reverter and Rights of Entry?*, 42 N.C.L. REV. 807 (1964).

Because the alienability and devisability of possibilities of reverter and powers of termination allow grantors to evade the check of the Rule Against Perpetuities on remote executory interests, an occasional statute forbids the conveyance or devise of these interests. *E.g.*, ILL. ANN STAT. ch. 30, § 37b (Smith-Hurd 1969). These statutes seem to treat the symptoms, not the disease, and have some deleterious side effects: the grantor's reverter interest remains enforceable but it must pass by intestacy, fractionating it to the point where no one can buy a release of the possibility of reverter or power of termination. Other approaches have been more fruitful (for example, so-called reverter acts limiting the duration of possibilities of reverter and powers of termination to a fixed period, say 30 or 40 years). *E.g.*, *id.* § 37e. The only current North Carolina stricture is the requirement of the Marketable Title Act that the interest be rerecorded once each 30 years to preserve its vitality. N.C. GEN. STAT. ch. 47B (1976).

423. 3 L. SIMES & A. SMITH, *supra* note 5, § 1245.

424. *Hardy Bros. v. Galloway*, 111 N.C. 519, 15 S.E. 890 (1892).

void.⁴²⁵

E mortgaged the land without giving *G* a chance to repurchase. *Held*, the right to repurchase was void.

If *G*'s right to repurchase had been cast in the form of a possibility of reverter, undoubtedly it would have been held good; but in the form of a right to repurchase it was held bad. The fault, if there be one, may lie in the exemption of the possibility of reverter rather than the invalidation of the right to repurchase.⁴²⁶

From a broader perspective, it is questionable whether the right to repurchase (or any other commercial interest) ought to be measured against the Rule Against Perpetuities. The period of the Rule—lives in being plus twenty-one years—is a fairly appropriate yardstick for family settlements (wills and trusts giving away the owner's property with future interests to his remote descendants), but is not an appropriate unit of measure for most commercial interests.⁴²⁷ Often no lives in being can be related to the commercial interest, leaving only the twenty-one-year period in gross for measurement of validity, an arbitrary period unrelated to any commercial property consideration.

The true objection to the option to repurchase in Case 33, if any, rests in the rule against restraints on alienation. Indeed, the language of the deed in Case 33 virtually forbade alienation to anyone save the grantor. The court's opinion in Case 33 did not clearly indicate the basis for the decision,⁴²⁸ although it has been read as relying on the

425. *Id.* at 520, 15 S.E. at 890.

426. *E.g.*, 6 ALP, *supra* note 22, § 24.56.

427. In some cases, the perpetuities period might be too short, in others it might be too long. An option to purchase exercisable, if at all, within the perpetuities period ought not to be automatically valid. *Id.*

428. The court stated:

Considered either as a conditional sale or a contract to reconvey, his Honor was entirely correct in holding as void for uncertainty the provision in the deed respecting the right of the grantor to repurchase the land when sold. No time is fixed for performance, nor is there any stipulation whatever as to the price to be paid.

The provision, not being a limitation, can therefore only take effect, if at all, as a condition subsequent, and viewed in this light we cannot hesitate in deciding that the restriction upon alienation attempted to be imposed after the grant of the fee, is repugnant to the nature of the estate granted, contrary to the policy of the law, and therefore inoperative. Ever since the statute of *Quia Emptores*, the right of alienation has been considered as an inseparable incident to an estate in fee . . . and, except in some cases where the restriction is only partial, the law does not recognize or enforce any condition which would directly or indirectly limit or destroy such a privilege—*iniquum est ingenuis hominibus non esse rerum suarum alienationem*. Accordingly, it has been held by this Court that a condition that a devisee in fee shall not sell or encumber his land before attaining the age of thirty-five is void, "because it is inconsistent with the full and free enjoyment which the ownership of such an estate implies." . . . To the same effect has it been ruled as to a condition that a devisee in fee shall make oath "that he will not make any change during his life" in the testator's will respecting his property . . . , or that he

Rule Against Perpetuities.⁴²⁹ The court may have been wise in leaving open the question of options to repurchase and perpetuities, and it may be significant that the only other North Carolina case on options to repurchase does not invalidate the option in question:

*Case 34.*⁴³⁰ As part of the sale of an oil distributorship, *P* deeded a bulk station and plant to *B*, who gave back to *P* an option to purchase the property at any time within one year, with automatic renewal from year to year, subject to cancellation on 60-days' written notice. About a year later, *B* agreed to allow *P* to exercise the option but *B* reneged and refused to execute a deed to *P*, contending the option violated the Rule Against Perpetuities. *Held*, for *P* for two reasons. First, *B* agreed to exercise of the option. Second,

the option is an integral part of the transaction, and it would be inequitable to allow [*B*] to claim the property under a deed from [*P*] and at the same time annul the essential terms of its acquisition. If the option is to go out, so must the deed which induced it. . . . The result, therefore, would be the same whether upheld or rejected.⁴³¹

Under traditional doctrine, the first reason for the decision (that *B* agreed to the repurchase) would seem inadequate—the question is what might have happened, judged from the creation of the interest,

shall not offer to mortgage or suffer a fine or recovery . . . , or that he shall contract in writing not to alienate before the proceeds of certain realty are paid to him . . . , or that land devised to a number of persons shall not be divided. . . .

Such conditions are not sustained where they "infringe upon the essential enjoyment and independent rights of property, and tend manifestly to public inconvenience."

"A condition annexed to an estate given is a divided clause from the grant, and therefore cannot frustrate the grant precedent, neither in anything expressed nor anything implied, which is of its nature incident and inseparable from the thing granted."

While unable to find any decision exactly in point, we feel assured that our case falls within the principle stated and illustrated by the foregoing authorities. The restriction is certainly inconsistent with the ownership of the fee as well, it would seem, as against public policy. The right to repurchase is of indefinite extent as to time (it being reserved to the grantors, their heirs or assigns), and may be exercised whenever the property is sold, although no amount is fixed upon as purchase-money. In other words, we have an estate in fee without the power to dispose of or encumber it, unless first offering it for no definite price to the grantors, their heirs or assigns. The condition is repugnant to the grant, and therefore void. Even if the right to repurchase could be sustained, the defendant has no cause of complaint, inasmuch as the Court in decreeing foreclosure has ordered that thirty days notice of the sale shall be personally served on him.

Hardy Bros. v. Galloway, 111 N.C. 519, 522-24, 15 S.E. 890 (1892)(citations omitted).

429. See Christopher, *Options to Purchase Real Property in North Carolina*, 44 N.C.L. REV. 63, 78 n.67 (1965).

430. *Pure Oil Co. v. Baars*, 224 N.C. 612, 31 S.E.2d 854 (1944).

431. *Id.* at 615, 31 S.E.2d at 856.

not what in fact happened. The other reason, that the option was an integral part of the transaction,⁴³² seems to confuse the secondary question of effect of invalidity with the primary question of validity or invalidity. To contend that invalidity of the option voids the initial transfer is to assume the conclusion; Case 33 simply stripped away the invalid option, leaving the grantee with a fee simple absolute. Furthermore, it would seem that in most cases the option would be an integral part of the transaction: the grantor in Case 33 was unlikely to have conveyed if the grantee had been unwilling to assent to the option to repurchase.

For the advocate, as well as the analyst, the significance of Cases 33 and 34 is that they leave open the question of validity of options to repurchase *under the Rule Against Perpetuities*. Case 33 may have been based on restraints on alienation, and Case 34, wherein the option in question was validated, is not a square holding that options are subject to the Rule. Although options to repurchase generally are subject to the Rule in other jurisdictions,⁴³³ there is still time for critical scrutiny of this application in North Carolina. It may well be that a more appropriate check for validity would be the rule against restraints on alienation. If, for example, the option to repurchase were exercisable at a price stated in the option (such as the \$3500 stated for exercise of the so-called possibility of reverter in Case 32), in times of constantly inflating land values the option would almost certainly restrain alienation because the option price quickly would become archaically low. Even if the price were high enough, the owner would be discouraged from placing improvements on the land.⁴³⁴ In Cases 33 and 34 no purchase price was stated; it would seem that uncertainty about the option price would discourage the owner from attempting to sell his property, lest he become involved in a lengthy haggle over the option price with the risk that the optionee ultimately would prevail. Even if the price were assumed to be current fair market value, the option might fail because in the difficult case of the preemptive right to repurchase, the option sometimes is held bad.⁴³⁵ The preemptive right to repurchase gives the vendor the right to repurchase the property at the same price at which the vendee is willing to sell to any third person. Because the preemp-

432. The Restatement adopts this idea, with citation only of *Pure Oil v. Baars*, 244 N.C. 612, 31 S.E.2d 854 (1954), as supporting authority. RESTATEMENT OF PROPERTY § 394, Comment f (Supp. 1948).

433. See, e.g., 6 ALP, *supra* note 22, § 24.56.

434. Strictly speaking, this is not a perpetuities or restraint on alienation factor, but it is often used as a rationale. Compare Case 36 *infra*.

435. E.g., *Atchison v. City of Englewood*, 463 P.2d 297 (Colo. 1969), noted in 47 DENVER L.J. 78 (1970).

tive right discourages marketability, but not greatly so, the cases and commentators on validity of the preemptive right have yet to reach a consensus.⁴³⁶

The options in Cases 33 and 34 were options to repurchase reserved by the original vendors. If these options, very much akin to the valid possibility of reverter in Case 32, are in jeopardy, clearly options in gross granted to third parties are in greater jeopardy, although the issue has not arisen in North Carolina. The option in gross reserved by the grantor or given to a third party is conventionally distinguished from the following two cases:

*Case 35.*⁴³⁷ *L* leased a parcel to *T* for a period of ten years. Upon the expiration of the ten-year period, if the property had been kept in a good state of repair, and if *T* so desired, the lease was renewable for an additional ten years, and thereafter renewable every ten years so long as *T* desired. The lease inured to the benefit of and was binding on the heirs and assigns of *L* and *T*. *Held*, the lease created a lease for a term of ten years, with a covenant for perpetual renewal.⁴³⁸ The covenant for perpetual renewal was a presently vested interest and did not violate the Rule Against Perpetuities.

*Case 36.*⁴³⁹ *L* leased a tract to *T* for a period of twenty years, with an option to renew for four periods of five years. A few months later *L* granted *T* a preemptive right to purchase a second tract adjoining the leased tract. In another few months, *L* sold the second tract without giving *T* a chance to purchase and *T* sued for specific performance of the option. *L* invoked the Rule Against Perpetuities. *Held*, the option was not objectionable (semble).⁴⁴⁰

436. See 5 R. POWELL, *supra* note 22, § 770(1).

437. *Dixon v. Rivers*, 37 N.C. App. 168, 245 S.E.2d 572 (1978) (2-1 decision).

438. Compare Case 35 with *Duff-Norton Co. v. Hall*, 268 N.C. 275, 150 S.E.2d 425 (1966). The lessor argued for a tenancy at will under the doctrine that a tenancy at the will of the tenant is *pro facto* at the will of the landlord. Other constructions were possible. See, e.g., *McLean v. United States*, 316 F. Supp. 827 (E.D. Va. 1970).

439. *Duff-Norton Co. v. Hall*, 268 N.C. 275, 150 S.E.2d 425 (1966).

440. The court's opinion is cryptic:

The defendants invoke the rule against perpetuities, since the option of the plaintiff could extend for a total period of 40 years. However, at this stage of the proceedings we are of opinion that this position is premature. *Mercer v. Mercer* . . . *Weber v. Texas Co.* . . . where it is said: " * * * This is not an exclusive option to the lessee to buy at a fixed price which may be exercised at some remote time beyond the limit of the rule against perpetuities, meanwhile forestalling alienation. The option simply gives the

Under Case 35 a covenant for perpetual renewal is presently vested and therefore free from the Rule. Although this rationale is a common one,⁴⁴¹ it begs the question: if an option to renew a lease (at some future time) is presently vested, why is not an option to repurchase (at some future time) (Case 33) also vested? The true explanation for Case 35 seems to be not that the option to renew is vested (else most options would seem vested), but rather that for various reasons unrelated to vesting the interest serves a desirable purpose, *viz.* encouraging the lessee to make full utilization of the land⁴⁴² or (for long-term leases) furthering alienability, since it is an accepted commercial device for disposing of land.⁴⁴³ In other words, because in these commercial interest cases the concept of vesting is a difficult fit, the cases seem rather to be retreating to Lord Nottingham's view of a perpetuity: "wherever any visible inconvenience doth appear."⁴⁴⁴ While it is well to consider such policies, it is unfortunate that the cases must be argued in terms of vesting, because the court may be forced to sustain an interest that, measured by all relevant factors, might not be desirable. A perpetual covenant to renew by definition may last forever, which is altogether too long a time.

Case 35 is significant on the specific score of covenants for perpetual renewal and on the general score of illustrating the more or less omnipresent possibility of labeling a commercial interest good because it is presently vested.⁴⁴⁵

lessee the prior right to take the lessor's royalty interest at the same price the lessor could secure from another purchaser whenever the lessor desires to sell. It amounts to no more than a continuing and preferred right to buy at the market price whenever the lessor desires to sell. This does not restrain free alienation by the lessor. He may sell at any time, but must afford the lessee the prior right to buy. The lessee cannot prevent a sale. His sole right is to accept or reject as a preferred purchaser when the lessor is ready to sell. The option is therefore not objectionable as a perpetuity."

Id. at 277, 150 S.E.2d at 427-28 (quoting *Weber v. Texas Co.*, 83 F.2d 807, 808 (5th Cir. 1936)). The purpose of citing *Mercer v. Mercer*, a trust duration case, is not clear.

In *Duff-Norton* it did not appear that the lessor challenged the validity of the covenant to renew (as distinguished from the option), but Case 35 appears to settle the validity of the covenant. Alternatively, the court could have simply decided that at most the covenant could only have resulted in a 40-year term, and an estate for a term is good.

441. J.C. GRAY, *supra* note 22, § 230.

442. RESTATEMENT OF PROPERTY § 395, Comment a (1944).

443. 3 L. SIMES & A. SMITH, *supra* note 5, § 1244.

444. *Duke of Norfolk's Case*, 22 Eng. Rep. 931, 946, 960 (Ch. 1682).

445. Another plausible theory, apparently not recognized in any cases, would start from the premise that so long as a person has the power to make himself the full owner of property at will (as by revoking a revocable trust), the property is not tied up, and the perpetuity period begins to run only when the power is terminated. *E.g.*, 6 ALP, *supra* note 22, § 24.59. It is arguable that the optionee's power to exercise the option is analogous to the settlor's power of revocation, so the perpetuities clock does not start to run until the exercise of the option. This bizarre twisting of

Case 36 appears to sustain another interest in the lessee, an option to purchase (as distinguished from the option perpetually to renew in Case 35). On the face of it, an option to purchase in a lessee is just as likely to be exercised remotely as the option to repurchase in Case 33, yet the lessee's option is sustained. The conventional explanations are two: (1) it would be anomalous to validate the perpetual option to renew in Case 35 but to invalidate the similar option to purchase in Case 36;⁴⁴⁶ and (2) the option to purchase furthers alienability because it encourages the tenant to improve the land.⁴⁴⁷ This second rationale is strained in Case 36 because the option in the tenant was not to purchase the leased land but rather to purchase an adjoining parcel.⁴⁴⁸ The court's announced rationale was a preemptive option one—the option price was the price at which the lessor was willing to sell to any third party.⁴⁴⁹ So, Case 36 may shed some light on the status of preemptive rights to repurchase in North Carolina.⁴⁵⁰ Its result is typical.⁴⁵¹

In Case 36, the court may have overlooked a convenient rationale for finding the option valid. The facts stated that the lessor granted the option to the lessee (with no mention of the lessee's heirs or assigns). If the option was personal to the lessee, under conventional dogma the option had to be good—it was exercisable, if at all, only by the lessee, who was the measuring life. This theory was not available in Cases 32, 33 and 35, in which the challenged interest ran to heirs and assigns, but might have been available in Case 34 (the facts were unclear).⁴⁵² The advocate in commercial interest cases should always check his case to see whether the commercial interest is limited to the life of one of the parties.

In addition to the theories that the challenged interest is presently vested or that the interest is personal to the optionee, some other exculpatory theories may be available:

conventional perpetuities concepts again illustrates the poor fit of the Rule to commercial interests.

446. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1244.

447. *Id.*

448. The facts do not detail the relationship between the parcels. It may have been that the existence of the option to purchase the adjoining tract encouraged development of the leased tract.

449. The case quoted by the court, *Weber v. Texas Co.*, 83 F.2d 807 (5th Cir. 1936), did involve a tenant's option to purchase the leased interest.

450. See text accompanying notes 423-26 *supra*.

451. 3 L. SIMES & A. SMITH, *supra* note 5, § 1244.

452. If the option runs to the optionee's heirs but is not enforceable against the optionor's heirs, it is good, the optionor becoming the measuring life.

*Case 37.*⁴⁵³ In return for \$200, *H* conveyed to *G* all the timber cut on fifty acres of *H*'s land. *G* was allowed "the full term of five years within which to cut and remove the timber hereby conveyed, said term to commence from the time [*G*] begins to manufacture said timber into wood or lumber."⁴⁵⁴ Thirteen years had elapsed without action by *G*. *Held*, the contract created a lease for a term of years, which was void for uncertainty as to when it would commence.

This is a classic "administration contingency" case; although the opinion nowhere mentions the Rule Against Perpetuities, the decision is consistent with usual principles invalidating interests to take effect on a condition precedent that might not occur within the period of the Rule (*G*'s commencing to cut the timber). The case belies any contention that contracts always are exempt from the Rule.⁴⁵⁵ It raises anew the question whether the period of the Rule is appropriate (either too short or too long) for commercial transactions. *G* attempted to save the deal by arguing that he was to commence cutting within a reasonable time. This argument is a useful one to keep in mind in this kind of case, since in most cases a reasonable time would be less than twenty-one years.⁴⁵⁶ Nevertheless, *G*'s argument failed here since the court said that thirteen years was beyond a reasonable time, so *G*'s rights under the contract were lost. Apparently, then, the court was not quite applying a perpetuities yardstick to invalidate the contract, since the interest would have vested, if at all, within less than thirteen years.⁴⁵⁷ On an ad

453. *Gay Mfg. Co. v. Hobbs*, 128 N.C. 46, 38 S.E. 26 (1901). Compare *Case 37* with 3 L. SIMES & A. SMITH, *supra* note 5, § 1242.

454. *Id.* at 47, 38 S.E. at 26.

455. The court does not state whether the contract was personal to *G* or whether it also ran to *G*'s successors. Even if the contract had been limited to *G* the interest would not have been saved, since *G* was a corporation and not a human being.

456. See 3 L. SIMES & A. SMITH, *supra* note 5, § 1244.

457. *Case 37* has been read as a perpetuities case. See 39 N.C.L. REV. 93, 97 & n.31 (1960). The opinion in *Case 37* may waive a perpetuities flag, but it does not expressly defend it:

We are of the opinion that there is on the face of the pleadings an insuperable obstacle to a recovery on the part of the plaintiff, and that we ought . . . to affirm the judgment of the Court below. . . . The matter to which we refer is that provision of the contract by which is granted the full term of five years within which to cut the timber, the term to commence from the time the plaintiff (party of the second part) begins to manufacture the timber into wood or lumber. We think that that feature of the contract renders the whole void. The contract may be treated as a lease, or a term for years, for a lease can be made of the right to cut trees or dig minerals. An indispensable legal requirement to the creation of a lease for a term of years is that it shall have a certain beginning and a certain end. Blackstone says that such an estate is frequently called a term, *terminus*, because its duration or continuance is bounded, limited and determined. If no time at which a lease is to commence has been mentioned, the law would fix that time as of the date of the contract. . . . But there is an attempt to fix the beginning of the

hoc policy basis the decision seems good: *G* should not have been allowed to tie up *H*'s timberland indefinitely, speculating on when timber prices would rise.

From the perspective of the Rule Against Perpetuities, without looking at underlying policies, the decision in Case 37 is difficult to justify. *G*'s interest seemed vested, with only his enjoyment postponed. His power to make himself the owner of the timber seemed no less contingent than the possibility of reverter in Case 32 or the option to renew the lease in Case 35; yet it was invalidated, again illustrating the necessity of an interest-by-interest analysis of underlying policies.⁴⁵⁸

Easements and profits *à prendre* usually are excepted from the operation of the Rule:

*Case 38.*⁴⁵⁹ *C* conveyed a tract of land to *S*, reserving to himself and his heirs and assigns the right to hunt on the tract and to protect the game on the tract from all persons except *S* and his successors. *Held*, the reservation retained a profit *à prendre* in *C*, which interest was present, not future, and did not violate the Rule Against Perpetuities.

Case 38 thus employs the present interest rationale appropriately to

lease in the contract before us. It is when the plaintiff shall begin to manufacture the timber into lumber. That act on the part of the plaintiff may never take place; it is entirely uncertain. The plaintiff can not be made to commence to manufacture the timber into wood or lumber, and no rule can be thought of by which the commencement of the term can be fixed. It is evident from the reading of the contract that the fee in the land was not to pass, and yet no one can tell how long the land and the other timber upon it may remain useless to the defendants and to the Commonwealth under the indefinite and uncertain time at which the lease is to begin.

If the doctrine of reasonable time could be invoked in this case, the plaintiff would be in no better condition than he now occupies. The price was \$200 for the timber, 14 inches on the stump *when cut*, and the defendants to pay all taxes, and the contract made 13 years ago, and not a stick of timber yet cut by the plaintiff. Under these circumstances it would certainly be held as matter of law that the plaintiff had been allowed a reasonable time to cut the timber to elapse, and not having done so, its rights under the contract had been lost. The judgment below is Affirmed.

Gay Mfg. Co. v. Hobbs, 128 N.C. 46, 47-48, 38 S.E. 26, 26 (1901)(citations omitted).

458. Case 37 is not unlike *Haggerty v. City of Oakland*, 161 Cal. App. 2d 407, 326 P.2d 957 (1958), which held a lease that was to commence on the completion of a building to be void *ab initio*. *Haggerty* was roundly criticized for importing the Rule Against Perpetuities into a foreign context and for ignoring the parties' likely intention that the building be constructed within a reasonable time less than 21 years. *E.g.*, 6 ALP, *supra* note 22, § 24.21 (Supp. 1977). *Contra*, 39 N.C.L. REV. 93 (1960). *Haggerty* was overruled in *Wong v. Di Grazia*, 60 Cal. 2d 525, 386 P.2d 817, 35 Cal. Rptr. 241 (1963). In view of the short-term interest in Case 37, and the fixed price (*Haggerty* involved a 10-year term in a large building at a rental keyed to gross income, which would increase with inflation), Case 37 appears to be reasonably decided, while *Haggerty* clearly was not.

459. *Council v. Sanderlin*, 183 N.C. 253, 111 S.E. 365 (1922).

sustain a profit.⁴⁶⁰ Any other decision would invalidate most easements, profits, covenants and incorporeal hereditaments.⁴⁶¹ These interests have escaped the Rule even when closer to the option in gross line:

*Case 39.*⁴⁶² *F* conveyed to *T* a "right of way and easement" to lay and maintain a gas pipe line, together with the right from time to time to lay one or more additional pipe lines approximately parallel to the original line; provided that *T* should pay *C* \$1.00 per lineal rod of the additional line. *Held*, the right to lay the additional lines was presently vested and did not violate the Rule Against Perpetuities.

In this case of an expansible easement, the interest was analogous to an option to purchase: by paying an additional sum of money, *T* could acquire additional rights in *F*'s property.⁴⁶³ Nevertheless, in contrast to options to purchase in gross, the expansible easement was sustained. Both interests seem equally vested or equally contingent, so the reasons for validity of one (the expansible easement) and invalidity of the other (the option in gross) must lie in subliminal policy factors. These factors have not been adequately explained,⁴⁶⁴ and the advocate might find a useful line of attack in questioning whether the utility of a given expansible easement outweighs its fettering.⁴⁶⁵

One final example deserves mention:

460. The profit was reserved to the grantor, as in Case 32, but even if conveyed to a third party, it would be good. See 3 L. SIMES & A. SMITH, *supra* note 5, § 1248. The profit was not restricted to *C*'s lifetime, so *C* could not be used as the measuring life.

461. Simes and Smith point out that generally these interests make the land more readily salable, although that would not seem to be true in Case 38. *Id.* § 1248.

462. *Feldman v. Transcontinental Gas Pipe Line Corp.*, 9 N.C. App. 162, 175 S.E.2d 713 (1970).

463. Powell places Case 38 also in the expansible easement category. 5 R. POWELL, *supra* note 22, ¶ 771[2] n.21. In a sense, the owner of the profit had a right dependent on his future action (hunting), but it was not expansible (for example, to include fishing) and did not require any future payments.

464. The *Restatement* retreats into a "present interest" conceptualization, RESTATEMENT OF PROPERTY § 399, Comment a (1944), as does Gray, J.C. GRAY, *supra* note 22, § 279. The treatises move to the edge of policy but do not plunge into the thicket. 5 R. POWELL, *supra* note 22, ¶ 771[2]; 3 L. SIMES & A. SMITH, *supra* note 5, § 1248.

465. Case 39 (the valid expansible easement) is an interesting comparison to Case 37 (the invalid timber lease to commence upon cutting). Compare these cases with RESTATEMENT OF PROPERTY § 399, Illustration 3 (1944). Both cases involved rights to make use of the land of another, which were to commence upon action and the payment of money by the holder of the right. Yet one was held good and the other bad, suggesting that the advocate carefully categorize his interest. Perhaps the difference between the cases lies in precedent or perhaps it lies in a kind of option appendant theory—the expansible easement in Case 39 was attached to a basic easement, something like a valid option to purchase attached to a lease, but the timber lease in Case 37 was not attached to any other, valid interest, and thus was not justifiable as encouraging full utilization of the base interest.

*Case 40.*⁴⁶⁶ A company establishes a pension, profit sharing, stock bonus or other employee trust for the purpose of distributing the income and principal thereof to some or all of its employees, or the beneficiaries of such employees. The trust may last beyond the period of the Rule, may benefit persons not in being at the creation of the trust, and may vest interests beyond the period of the Rule. *By statute* the trust would not violate the Rule Against Perpetuities (nor the rules against restraints on alienation or against accumulation of income).

Pension trusts for employees should not be subject to the Rule,⁴⁶⁷ and apparently no court has held them bad.⁴⁶⁸ Nevertheless, because they probably are not exempt from the Rule as charitable trusts (since there is no direct benefit to the public), and because they resemble the kinds of dispositions in private express trusts that would run afoul of the Rule, several states, including North Carolina, have enacted salutary statutes to protect the validity of pension trusts.

In what kinds of commercial arrangements then should counsel be wary of perpetuities violations? By way of summary, there seem to be three categories: (1) any transaction involving land or an interest in land (for example an estate for years);⁴⁶⁹ (2) any arrangement providing death benefits or payments often associated with estate planning;⁴⁷⁰ and (3) any contract involving unique chattels.⁴⁷¹ The North Carolina cases illustrated in this section pretty well run the gauntlet of problem areas, but counsel should always be wary of perpetuities risks in new kinds of property arrangements.

If a court wishes to validate a commercial interest without any

466. See N.C. GEN. STAT. § 36A-6 (Supp. 1977).

467. *E.g.*, 3 L. SIMES & A. SMITH, *supra* note 5, § 1247.

468. *Id.*

469. For example, the profits and easements in Cases 38 and 39 and the timber lease in Case 37, as well as the perhaps more expectable challenges to possibilities of reverter in Case 32 and the options to purchase, repurchase and renew in Cases 33-36. Questions have also been raised for restrictive covenants, *id.* § 1246, and for certain condominium provisions (1) determining ownership of the airspace in the event of destruction of the building and (2) providing for the control of ownership of the condominium. see Seeber, *Condominiums in North Carolina: Improving the Statutory Base*, 7 WAKE FOREST L. REV. 355, 359, 361-65 (1971). Anytime land is involved, look out!

470. For example, pension trusts for employees (Case 40). Similar questions have arisen for contracts (often with a life insurer) providing for future payments to unborn or unascertained beneficiaries, because of the similarity of such arrangements to trusts used in estate planning. So far such contracts have escaped the Rule (on the facile theory that the relationship is purely contractual), but Leach opines that if abused, such contracts would be in jeopardy. 6 ALP, *supra* note 22, § 24.58.

471. *Id.* § 24.56 & n.7.

penetrating analysis of policy considerations, it may simply declare that the case involves a contract or a present interest, or it may find that the Rule does not apply (outside of gratuitous dispositions) to interests in personal property. Assuming that the Rule is found generally to apply to the interest in question, the interest may nevertheless be validated in a particular case if it is personal to a person such as an optionee (who then becomes the measuring life) or if the parties contemplated performance of the agreement within a reasonable time not exceeding the period of the Rule. As discussed, the cases tend to be decided by label or precedent, without inquiry into the policies served by a holding of validity or invalidity. It would be better not to apply the Rule to commercial interests, for the reasons that the concept of vesting is not a good fit and the period of the Rule is not appropriate. Nevertheless, for the foreseeable future it appears that the debate will be limited to Rule Against Perpetuities terms. Counsel in these cases might profit by arguing the underlying policies, such as free alienability or full use, which seem to control the decisions.

VII. DRAFTING

The treatises contain several excellent prescriptions for avoiding violation of the Rule.⁴⁷² The caveats will be summarized here.

(1) *Examine every instrument for possible violations of the Rule.* Wills and trusts are obvious candidates for scrutiny, but the commercial interest cases show that the Rule may pop up in unexpected places.

(2) *State the duration of options to purchase land.* Limit them to the life of the optionee or, if not personal, state a definite period not greater than twenty-one years.

(3) *Avoid agreements or gifts on conditions unconnected with any life.* Beware of administration contingencies such as completion of a building, probate of a will, distribution of an estate, or payment of debts. If the condition cannot be avoided, add a proviso that the event must take place within the period of the Rule.

(4) *Beware of gifts contingent upon the taker attaining an age over twenty-one.* Indeed, whenever one sees a number greater than twenty-one, he should be on his guard.

(5) *Beware of gifts to grandchildren.* While gifts to grandchildren of the testator must perforce be good, gifts to another's grandchildren

472. 6 ALP, *supra* note 22, § 24.7; 3 L. SIMES & A. SMITH, *supra* note 5, § 1293; Leach, *supra* note 29, at 669-71; Leach, *supra* note 334, at 985-86; Phillips, *supra* note 130, at VII-17 to -19.

may be bad. Indeed gifts to grandchildren of the settlor of an irrevocable trust may be bad, because more children may be born to the settlor.

(6) *When possible, describe beneficiaries by name rather than by class designation.* This will eliminate many of the fertile octogenarian casualties.

(7) *When possible, avoid gifts conditioned on the survival of the "widow" of a named person.* This will eliminate any "unborn widow" problems. Identifying the wife by name will avoid the problem but would exclude a second spouse; several better alternatives are available.⁴⁷³

(8) *Limit the duration of trusts to the period of the Rule.* Even though the Rule may not apply to the duration of trusts, it is better not to run the risk. Furthermore, the trustee of a trust lasting beyond the perpetuities period may find his powers stripped away on the theory that they constitute remotely exercisable powers of appointment.

(9) *Examine every exercise of a power of appointment for possible violations of the Rule.* For special powers and general powers exercisable by will, the period is computed from the creation of the power. Beware of provisions that are in substance, but not in form, powers of appointment, such as powers to consume or revoke.

(10) *Consider the insertion of a saving clause.* Feelings run high on this question. Leach recommends a boilerplate saving clause to protect against errors.⁴⁷⁴ Simes and Smith eschew the practice on the theory that it may produce unanticipated results.⁴⁷⁵ If the attorney does not know whether the instrument he has drawn is valid, he probably has no business drawing it.

VIII. REFORM

It is useful initially to separate questions of application of the Rule from the principle and purpose of the Rule. The nonsense applications

473. 3 L. SIMES & A. SMITH, *supra* note 5, § 1293, at 233-34.

474. Leach, *supra* note 334, at 985-86. The Wachovia Form is as follows:

Anything in this will to the contrary notwithstanding, no trust (other than a trust of a vested interest) created hereunder shall continue beyond 21 years after the death of the last to die of those beneficiaries who were living at the time of my death; and upon the expiration of such period all trusts shall terminate and the assets thereof shall be distributed outright to such persons as are then entitled to the income therefrom and in the same proportions; but if no person is then entitled to a specific portion of income, then to the then living income beneficiaries, per stirpes.

WACHOVIA BANK & TRUST, *supra* note 352, at XVI-32.

475. 3 L. SIMES & A. SMITH, *supra* note 5, § 1295.

of the Rule are well known,⁴⁷⁶ and the North Carolina cases embody some, but not all, of them. Here the Rule has sporadically been applied to some commercial interests (for example, rights to repurchase), although a Rule designed to regulate family settlements has no rational bearing on the commercial world. Anomalously, the land use restrictions most deserving of perpetuities measurement, possibilities of reverter and powers of termination, are free from the check of the Rule. The duration of trusts, while generally exempt from the Rule elsewhere, may or may not be regarded as a question of perpetuities in this State. Authority is too sparse on powers of appointment to draw many conclusions. For class gifts, the much-maligned all-or-nothing rule of *Leake v. Robinson* prevails. Often the opinions seem not to grasp antecedent constructional questions of maximum membership (class closing) and minimum membership (vesting). Apparently, the testator or grantor may choose measuring lives unrelated to the disposition, and all gifts qualify for a twenty-one year period in gross unrelated to any minority, removing the logical nexus between the Rule and family settlements.

Some applications of the Rule are not bad. There is some support for choosing that construction which avoids invalidity, although the presumption is applied randomly. While North Carolina has not embraced judicial cy pres or the wait-and-see doctrine to preserve validity, a leading case indicates that, if adopted, cy pres might be applied generously.⁴⁷⁷ There is no clear-cut administration contingency case, and medical evidence might be admissible to avoid a fertile octogenarian problem. No charitable gift has been invalidated for perpetuities reasons.

Perpetuities reform statutes are nearly as numerous as the several states.⁴⁷⁸ Most reforms tinker with the period of the Rule (for example, the California allowance of an alternative sixty year period in gross),⁴⁷⁹ attempt to cure some of the nonsense applications (for example the

476. See Schuyler, *supra* note 38.

477. *Stellings v. Autry*, 257 N.C. 303, 126 S.E.2d 140 (1962) (Case 14).

478. The literature includes: Committee on Rules Against Perpetuities, *Perpetuity Legislation Handbook*, 2 REAL PROP., PROB. & TR. J. 176 (1967); Dukeminier, *Perpetuities Legislation in California: Perpetual Trusts Permitted*, 55 CALIF. L. REV. 678 (1967); Eckhardt, *Perpetuities Reform by Legislation*, 31 MO. L. REV. 56 (1966); Leach, *Perpetuities: What Legislatures, Courts and Practitioners Can Do About the Follies of the Rule*, 13 KAN. L. REV. 351 (1965); Lynn, *The Ohio Perpetuities Reform Statute*, 29 OHIO ST. L.J. 1 (1968); Lynn, *Perpetuities Reform: An Analysis of Developments in England and the United States*, 113 U. PA. L. REV. 508 (1965); Schuyler, *supra* note 38; Note, *The Rule Against Perpetuities-Statutory Reform*, 20 CASE W. RES. L. REV. 295 (1968).

479. CAL. CIV. CODE § 715.6 (West Cum. Supp. 1979).

fertile octogenarian rule),⁴⁸⁰ or promulgate a statutory cy pres or wait-and-see doctrine.⁴⁸¹ In view of the constant problems caused by the Rule, it may be time to ask whether these statutes merely treat the symptoms and not the disease.⁴⁸² In this era of sunset laws and deregulation, could it not be that the Rule itself ought to be abolished?

Some beneficial aspects of abolition are readily apparent. Commercial interests would be free from jeopardy, and the courts would be forced to concentrate on relevant commercial policies, such as restraints on alienation, instead of trying to apply the ill-fitting Rule Against Perpetuities. Trust duration, which supposedly is not a matter of perpetuities, would be free at last. The charitable exemption of G.S. 36A-49 would be given its literal meaning, which the cases have heretofore equivocally sanctioned. And all those delightful doctrines of infectious invalidity, administration contingencies and "if at all" would be reduced to a footnote (albeit a long one) in the legal history books.

A large benefit of abolition would be removal of a substantial malpractice risk. The leading malpractice case stating that privity is no bar to suit by a disappointed beneficiary against the draftsman of an invalid will was (you guessed it!) a perpetuities case.⁴⁸³ While the court in that case exonerated the draftsman by seizing the question of negligence from the jury and declaring, in effect, that nobody understood the Rule, it is doubtful that future cases will treat perpetuities errors so kindly.⁴⁸⁴ The Leach recommendation that a saving clause be inserted

480. The Illinois statute would be unintelligible without a preceding indoctrination into common law perpetuities doctrines. See ILL. STAT. ANN. ch. 30, §§ 191-196 (Smith-Hurd Cum. Supp. 1978).

481. *E.g.*, KY. REV. STAT. § 381.216 (1970).

482. Cf. J.C. GRAY, *supra* note 22, at xi ("There is something in the subject which seems to facilitate error. Perhaps it is because the mode of reasoning is unlike that with which lawyers are most familiar.").

483. *Lucas v. Hamm*, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), *cert. denied*, 368 U.S. 987 (1962).

484. The leading English property law scholar, R.E. Megarry, commented on *Lucas v. Hamm* as follows:

An Englishman's comment on the decision must perforce observe a proper restraint. Doubtless the Supreme Court of California is the best judge of the standard of competence which is to be expected of California lawyers of ordinary skill and capacity. Let it be accepted that it is highly unlikely that it would take longer than the perpetuity period for the estate to be distributed. The question then becomes whether an ordinary lawyer who undertakes to draft a will should be expected to know that a gift will be void for perpetuity if there is any possibility, however unlikely, that the perpetuity period will be exceeded. This part of the rule is so fundamental, and so highly stressed by all the books and teachers, that he who does not know it must be expected to know little or nothing of the rest of the rule. The standard of competence in California thus seems to be that it is not negligent for lawyers to draft wills knowing little or nothing of the rule against perpetuities, and without consulting anyone skilled in the rule (a point mentioned by the

in most wills and trusts⁴⁸⁵ is testimony that perpetuities mistakes are inevitable.

Also, it might be noted that at least one state, Wisconsin, in effect has no Rule Against Perpetuities, and that state seems not to have been sunk into Lake Michigan by any dynastic impulses of its citizens. Wisconsin has no rule against remote vesting, although it does have a rule against suspension of the power of alienation measured by lives in being plus thirty (not twenty-one) years.⁴⁸⁶ Wisconsin cases have held that there is no suspension of the power of alienation for a trust if the trustee has a power of sale.⁴⁸⁷ Although this view was criticized,⁴⁸⁸ the Wisconsin legislature even reduced it to statutory writing in 1969.⁴⁸⁹ This large gap in perpetuities coverage seems not to have had an adverse effect. Further, the monstrous accumulations anticipated by the Thellusson Acts never materialized; Americans seem not inclined toward entailments of one kind or another.⁴⁹⁰

The benefits of repeal in eliminating the nonsense applications of the Rule are obvious. But what are the detriments? Here one must look at the underlying purposes of the Rule, and Simes has stated them admirably.⁴⁹¹ Briefly, they are: (1) promoting alienability of property;

Court of Appeal but ignored in the judgment of the Supreme Court). If the rule against perpetuities is in this category, what other fundamentals of the law are there of which the California attorney may be ignorant without culpability? How does California translate and apply *spondet peritiam artis*? However bright the future of *Lucas v. Hamm* may be in England on the score of privity, it is to be hoped that on the standard of professional competence it will prove to be a slur on the profession which, like the mule, will display neither pride of ancestry nor hope of prosperity.

81 LAW Q. REV. 478, 481 (1965).

See generally *Smith v. Lewis*, 13 Cal. 3d 349, 530 P.2d 589, 118 Cal. Rptr. 621 (1975) (failure to research community property rights in retirement benefits; attorney liable); *Heyer v. Flaig*, 70 Cal. 2d 223, 449 P.2d 161, 74 Cal. Rptr. 225 (1969) (failure to consider effect of contemplated marriage on will; attorney liable); *Bucquet v. Livingston*, 57 Cal. App. 3d 914, 129 Cal. Rptr. 514 (1976) (failure to recognize that power to revoke constituted a taxable general power of appointment; attorney liable); *Licata v. Spector*, 26 Conn. Supp. 378, 225 A.2d 28 (1966) (failure to secure sufficient number of witnesses to will; attorney liable); *McAbee v. Edwards*, 340 So. 2d 1167 (Fla. Dist. Ct. App. 1976) (erroneous advice that it was unnecessary to change will after marriage; attorney liable). But see *Berman v. Rubin*, 138 Ga. App. 849, 227 S.E.2d 802 (1976) (alleged negligent misrepresentation of child support agreement; attorney not liable; if law is not well settled, clear and widely recognized, attorney acting in good faith is insulated from liability).

485. See note 474 *supra*.

486. WIS. STAT. ANN. § 700.16(1), (5) (West 1969).

487. *Becker v. Chester*, 115 Wis. 90, 91 N.W. 87 (1902); *In re Butter's Will*, 239 Wis. 249, 1 N.W.2d 87 (1941); *In re Walker's Will*, 258 Wis. 65, 45 N.W.2d 94 (1950), noted in 49 MICH. L. REV. 1239 (1951); 35 MINN. L. REV. 617 (1951).

488. *Dede, Perpetuities in Private Trusts in Wisconsin*, 42 MARQ. L. REV. 514 (1959).

489. WIS. STAT. ANN. § 700.16(3) (West 1969).

490. See note 162 *supra*.

491. L. SIMES, PUBLIC POLICY AND THE DEAD HAND (1955).

(2) preventing undue concentrations of wealth; (3) furthering the competitive struggle; and (4) limiting dead-hand control. In view of a number of North Carolina statutes and one federal statute, and weighing the nuisance aspects of the Rule, it may be that these purposes are no longer so strongly served that retention of the Rule is justified.

First, note that G.S. 39-6⁴⁹² tends to reduce by one generation the period during which property transferred inter vivos is tied up. This statute generally allows the grantor of a future interest in real estate to a person not in being to revoke the interest at any time before the remainderman comes into being. It also allows the settlor of a trust creating a future interest in real or personal property to a person not in being or not determined until the happening of a future event to revoke the interest at any time before the birth of the remainderman or happening of the contingency. While there are gaps in the coverage of the statute,⁴⁹³ in general it makes every contingent future interest revocable during the creator's lifetime; in essence the creator has a power analogous to the power of revocation reserved in an ordinary inter vivos trust, for which the perpetuities clock does not start until the settlor's death.⁴⁹⁴ While the creator has the power to revoke, the property has not been tied up. The full import of this statute does not seem to have been recognized, nor has it been argued to postpone the starting of the period in any perpetuities case.

Second, the Rule does not substantially affect marketability. Most substantial dispositions of property are trusts of corporate stock, in which the trustee customarily is given a power to sell the trust corpus.⁴⁹⁵ Even in the absence of an express provision, a power of sale may be implied, at least when the trustee has an express duty to invest and reinvest or to invest and manage.⁴⁹⁶ Although the proceeds of sale will remain impressed with the trust, that is not a question of marketability but of other policies such as dead-hand control. Legal interests are similarly alienable. North Carolina generally takes a strict view

492. N.C. GEN. STAT. § 39-6 (1976).

493. For trusts, the statute applies to real or personal property and to future interests (apparently both remainders and executory interests) contingent upon birth or the happening of an event. For nontrust interests, the statute seemingly applies only to real estate (not personalty) and to future interests contingent upon birth (not the happening of an event).

494. *E.g.*, *Cook v. Horn*, 214 Ga. 289, 104 S.E.2d 461 (1958).

495. L. SIMES, *supra* note 491, at 40-54. The statutory list of powers that may be incorporated by reference includes a power of sale. N.C. GEN. STAT. § 32-27(2) (1976).

496. *E.g.*, *Hall v. Wardwell*, 228 N.C. 562, 46 S.E.2d 556 (1948); *cf.* *First Union Nat'l Bank v. Broyhill*, 263 N.C. 189, 139 S.E.2d 214 (1964) (power of sale will not be implied merely for greater convenience in administration).

toward restraints on alienation of legal estates. Also, G.S. 41-11 provides for sale and reinvestment of the proceeds when there is a vested interest in real estate and a contingent remainder over to unborn or unascertained remaindermen.⁴⁹⁷ Most of the gaps in the coverage of this statute (does it apply to personalty? to executory interests?) would seem to be filled by G.S. 41-11.1,⁴⁹⁸ which provides for sale and reinvestment of real or personal property when there is a vested interest followed by a gift over to a class, and one or more members of the class are *in esse* but the membership may be increased by persons not *in esse*. Any instrument attempting to keep property in the family for a long time would be forced to use class designations for future generations, exposing it to G.S. 41-11.1.

Third, the policies of preventing future concentrations of wealth and, correlatively, of furthering the competitive struggle were dismissed by Simes as matters of tax policy, not property law.⁴⁹⁹ Certainly there is no suggestion in the cases that these are the purposes of the North Carolina Rule.

Thus, the modern justification for the Rule lies in the injunction against dead-hand control: there should be a fair balance between the desires of present and succeeding generations to do what they wish with the property that they enjoy, and it is socially desirable that the wealth of the world be controlled by its living members.⁵⁰⁰ This proposition seems implicit in North Carolina judicial references to the fettering of property. Some North Carolina doctrines, however, do cut against this rationale. For equitable interests, it appears that beneficiaries may convey their interests, except under spendthrift trusts.⁵⁰¹ Furthermore, spendthrift restraints are virtually unenforceable in this State, since the statutory maximum amount of \$500 annual income has been rendered trivial by inflation.⁵⁰² It is not clear whether North Carolina would follow the *Claffin* doctrine, which refuses to terminate a trust when a material purpose of the settlor remains, even though all beneficiaries are ascertained and competent, and request termination.⁵⁰³

497. N.C. GEN. STAT. § 41-11 (1976).

498. *Id.* § 41-11.1.

499. L. SIMES, *supra* note 491, at 57-58.

500. *Id.* at 58-59.

501. *Mizell v. Bazemore*, 194 N.C. 324, 139 S.E. 453 (1927); *Bank of Union v. Heath*, 187 N.C. 54, 121 S.E. 24 (1924).

502. N.C. GEN. STAT. § 41-9 (1976); see *Mizell v. Bazemore*, 194 N.C. 324, 139 S.E. 453 (1927).

503. See *Turnage v. Greene*, 55 N.C. (2 Jones) 63 (1854); *Fowler v. Webster*, 173 N.C. 442, 92

For legal interests, the statutes make alienable all future interests in real or personal property, including executory interests and vested and contingent remainders.⁵⁰⁴ The doctrine of destructibility of contingent remainders, which furthers alienability, may still exist.⁵⁰⁵

It may be objected that these doctrines do not eliminate the need for the Rule Against Perpetuities, since the holder of a contingent interest is unlikely to sell a speculative interest for which he will not receive full value. But is this not a matter of his free choice? And might not a market develop in such interests?⁵⁰⁶

A stronger objection is that sale of one of these interests normally does not defeat any other contingent interests created by the dead hand; each generation may sell, but the next generation will take another remainder for life, impressed with the whim of the original testator or grantor. The spectre of a new millenium of entailments appears.⁵⁰⁷ This is the fundamental question, and the answer to it lies, *mirabile dictu*, in the Tax Reform Act of 1976 and its new tax on generation-skipping transfers.⁵⁰⁸ Under the Act, when a trust provides for income or corpus to two or more generations younger than the settlor, there is a tax substantially equivalent to the estate or gift tax that would have been imposed if the property had been transferred outright to the first generation then outright to the second generation.⁵⁰⁹ The tax is also imposed on generation-skipping equivalents, such as legal life estates and remainders.⁵¹⁰ With limited exceptions, a person is a beneficiary if he has a "right to receive income or corpus," which includes beneficiaries of discretionary trusts⁵¹¹ and donees of general or special

S.E. 157 (1917). Since North Carolina scarcely recognizes spendthrift trusts, it might not follow *Clafin*.

504. N.C. GEN. STAT. § 39-6.3 (1976). See also *id.* § 31-40 (what property passes by will).

505. See note 7 *supra*.

506. Apparently a market in inheritances is made in London. NEWSWEEK, Jan. 25, 1971, at 66.

507. Committee on Rules Against Perpetuities, *Further Trends in Perpetuities*, 5 REAL PROP., PROB. & TR. J. 333, 337 (1970):

If . . . tax-avoiding schemes are resorted to in Wisconsin for periods which are in flagrant disregard of the limits of traditional perpetuity law, it is not likely that the guardians of the Internal Revenue Code will allow the matter to pass without notice. Amendments of that Code, couched in terms of general applicability, but designed to plug gaps produced by peculiar local laws, are difficult to frame without creating traps for unwary draftsmen in other states. It would be a formidable undertaking to frame a federal estate tax so as to take into account a variety of local laws on perpetuities.

508. I.R.C. §§ 2601-2622.

509. *Id.* § 2611.

510. *Id.* § 2611(d).

511. *Id.* § 2613(d)(1).

powers of appointment.⁵¹² There is a "grandchild's exclusion" for "transfer[s] to a grandchild of the grantor," calculated at the rate of \$250,000 per "deemed transferor," that is, child of the grantor,⁵¹³ and this grandchild's exclusion is the key to the perpetuities analysis.

Suppose for example a grantor who, freed from the Rule Against Perpetuities, contemplates a trust of \$1,000,000 creating a series of life estates to his children, grandchildren, and great-grandchildren, remainder to his great-great-grandchildren. The Code would permit the arrangement, but there would be a tax disincentive: no grandchild's exclusion would be allowed because the life estate in the grandchildren would not be exposed to estate tax on the grandchildren's death.⁵¹⁴ Furthermore, even if a grandchild's exclusion were allowed, the grantor would be entitled only to a one-time exclusion, (because it is limited to transfers to the *grandchildren* of the grantor), whereas if the property were transferred to the children for life, remainder in fee to the grandchildren, and the grandchildren then transferred the property to their children for life, remainder in fee to their grandchildren, there would be two rounds of exclusions, with the number of exclusions measured by the number of children and great-grandchildren of the original grantor. Those to whom the exclusion is important will be in fairly high tax brackets, so they can be expected to terminate the trust at the level of grandchildren to secure maximum tax benefits, roughly at the outside limit of the existing Rule Against Perpetuities. They will have no tax incentive to create dynastic trusts, as they did before 1976 when only the Rule served to check these impulses.

There are, of course, limits to this line of argument. The new tax does not apply to trusts with only one generation younger than the grantor (for example, "to my wife for life, remainder to my grandchildren"),⁵¹⁵ but this arrangement seems justifiable in light of the benefits of abolition. Nor do the tax disincentives concern those persons with small estates, but given the pace of inflation, the federal estate and gift

512. *Id.* § 2613(d)(2).

513. *Id.* §§ 2613(b)(5)(6), 2612.

514. J. McCORD, 1976 ESTATE & GIFT TAX REFORM: ANALYSIS, EXPLANATION AND COMMENTARY 151 (1977).

515. *See* I.R.C. § 2613.

taxes will increasingly affect the middle class.⁵¹⁶ The benefits of abolition of the Rule Against Perpetuities may now be worth the price.⁵¹⁷

516. Professor Haskins advances the provocative thesis that the Rule originally was designed not so much as a check on perpetuities as it was a means of telling the new landed class how far it could safely go in tying up property. Haskins, *supra* note 50.

517. It should be stressed that this is only a preliminary analysis. As recently as 1958, the master future interests scholar Daniel Schuyler wrote, "no one has yet suggested that no rule against perpetuities should be retained." Schuyler, *Should the Rule Against Perpetuities Discard Its Vest?*, 56 MICH. L. REV. 683, 689 (1958). It is with no small trepidation that the author challenges 300 years of property law and generations of scholars. But the current justifications for the Rule seem hindsight rationalizations.

SURVEY OF DEVELOPMENTS IN NORTH CAROLINA LAW, 1978*

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Provisions of the North Carolina General Statutes are referred to in text as G.S.

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I. ADMINISTRATIVE LAW

A. *Open Meetings Law*¹

In response to the North Carolina Supreme Court's 1977 decision in *Student Bar Association v. Byrd*,² which curtailed the reach of the state Open Meetings Law,³ the General Assembly made important changes in the statute that affect both its coverage and notice provisions.⁴

The original statute provided:

All official meetings of the governing and governmental bodies of this State and its political subdivisions, including all State, county, city and municipal commissions, committees, boards, authorities, and councils and any subdivision, subcommittee, or other subsidiary or component part thereof which have or claim authority to conduct hearings, deliberate or act as bodies politic and in the public interest shall be open to the public.⁵

Plaintiffs in *Byrd* argued that this provision extended to meetings of the faculty of the University of North Carolina School of Law. Writing for the majority, Justice Lake, however, read the words "governing" and "governmental" in the conjunctive and held in essence that the use of the words "bodies politic" indicated that the statute was to cover only meetings of governing and governmental bodies that exercise sovereign powers not exercisable by private groups.⁶ Because decisions of the Law School faculty were subject to review by the University's Board of Governors (which the court denominated the true governing body of the school), the court held that the faculty was not a governing body; neither was it a component part of the Board of

1. A bill that will significantly revise the state Open Meetings Law is now pending in the General Assembly. H. 183, N.C. Gen. Assembly, 1979 Sess. Unless otherwise indicated, the new bill will not alter any of the recent changes discussed herein.

2. 293 N.C. 594, 239 S.E.2d 415 (1977).

3. The application of the Open Meetings Law, ch. 638, 1971 N.C. Sess. Laws 610 (codified as amended at N.C. GEN. STAT. §§ 143-318.1 to .8 (1978 & Interim Supp. 1978)), enacted in 1971 to provide public access to the decisionmaking process of public bodies, was challenged in *Byrd* by members of the Student Bar Association Board of Governors of the University of North Carolina School of Law who had been thwarted in their attempts to attend a general faculty meeting at the Law School. 293 N.C. at 595, 239 S.E.2d at 417. The trial court decision, affirmed by the court of appeals, 32 N.C. App. 530, 232 S.E.2d 855 (1977), enjoined defendants, including University of North Carolina School of Law Dean Robert Byrd, from holding closed meetings and required the dean to post written notice of meetings at least six hours before each meeting. 293 N.C. at 596, 239 S.E.2d at 417. The state supreme court reversed both holdings. *Id.* at 606, 239 S.E.2d at 423. See *Survey of Developments in North Carolina Law, 1977*, 56 N.C.L. REV. 843, 861-67 (1978).

4. N.C. GEN. STAT. §§ 143-318.1 to .4, .8, 153A-40, 160A-71 (Interim Supp. 1978).

5. Law of June 21, 1971, ch. 638, § 1, 1971 N.C. Sess. Laws 611 (formerly codified at N.C. GEN. STAT. § 143-318.2 (amended 1978)).

6. 293 N.C. at 601, 239 S.E.2d at 420.

Governors, the court said, but rather a "group of employees of the Board."⁷ The court in dictum went on to state that even if the faculty were a component part of the Board, the Board was not a governmental body and, therefore, neither the Board nor the faculty were required to hold public meetings. Governmental bodies, according to the court, must exercise powers exclusive to a sovereign political entity, and the operation of an educational system is not an exercise of a governmental power because private concerns can also carry out such activities.⁸

The revised statute requires that "public" bodies⁹ rather than "governing and governmental bodies" hold open meetings, and defines public bodies broadly to include any group with at least two members that is a part of government and that exercises "any legislative, policy-making, quasi-judicial, administrative, or advisory function."¹⁰ This general coverage, however, is restricted somewhat; G.S. 143-318.2(b)(2) requires that public bodies be formally established by

- (i) the State Constitution, (ii) an act or resolution of the General Assembly, (iii) a resolution or order of a State Agency, pursuant to a statutory procedure under which the agency establishes a political subdivision or public corporation, (iv) an ordinance, resolution, or other action of the governing board of one or more counties, cities, school administrative units, or other political subdivisions or public corporations, or (v) an executive order of the Governor or formal action of the head of a principal State office or department . . . or of a division thereof.¹¹

Because of the broad language of the new statute, it is clear that the General Assembly intended the original statute to have broader coverage than the court in *Byrd* interpreted it to have. The new language rejects the lengthy dicta in *Byrd* concerning governing and gov-

7. *Id.* at 602-03, 239 S.E.2d at 421.

8. *Id.* at 603-04, 239 S.E.2d at 421-22. In his dissent, Justice Exum objected to this narrow interpretation of the statute, and argued that a strict reading defeated the statute's purpose of ensuring that the public's business is conducted in the public view. *Id.* at 606-16, 239 S.E.2d at 423-29 (dissenting opinion).

9. N.C. GEN. STAT. § 143-318.2 (Interim Supp. 1978).

10. *Id.* § 143-318.2(b)(1). The statute clearly, however, does not extend to bodies that exercise a judicial function, *i.e.*, the courts. See REPORT OF THE LEGISLATIVE STUDY COMMISSION FOR STATE POLICIES ON THE MEETINGS OF GOVERNMENTAL BODIES 5 (1978) [hereinafter cited as REPORT OF THE LEGISLATIVE STUDY COMMISSION].

11. N.C. GEN. STAT. § 143-318.2(b)(2)(Interim Supp. 1978). In addition, if a group is a public body, its committees are also considered public bodies. *Id.* § 143-318.2(b). The statute also specifically subjects the governing boards of public hospitals to the open meetings requirement, *see id.*, in order to assure "coverage of non-profit corporations that operate hospitals owned by local government." REPORT OF THE LEGISLATIVE STUDY COMMISSION, *supra* note 10, at 5. Hospital committees that do not make policy, however, are exempted from the requirement. N.C. GEN. STAT. § 143-318.2(b) (Interim Supp. 1978).

ernmental bodies, including the observation that the University's Board of Trustees was not required to hold open meetings; however, it does not appear to affect the narrow holding of the case as it pertains to the Law School faculty because that body is not established by any of the described methods.¹² The language also appears to exempt nonprofit corporations appropriated money by the state¹³ as, for example, a chamber of commerce or a private university. In addition to these changes, the new statute specifically exempts the professional staffs of state agencies,¹⁴ because they are considered not to make final policy, and the Judicial Standards Commission,¹⁵ which has authority under its own statute¹⁶ to meet in confidential session.

Notice provisions varying with the type and circumstances of meetings were also enacted to clarify the diverse judicial interpretations that the original statute yielded. Originally, North Carolina was one of the few states that had no notice provision in its open meetings law.¹⁷ While many lower courts throughout the state read requirements of reasonable notice into the former statute on the basis that otherwise the

12. While it may be argued that a group such as the Law School faculty is established by the method set out in § 143-318.2(b)(2)(iv), the report of the committee that devised the new language indicates that subsection (iv) was intended to extend only to local units. *See* REPORT OF THE LEGISLATIVE STUDY COMMISSION, *supra* note 10, at 5.

13. Because nonprofit corporations are created by filing articles of incorporation, they do not meet the specific requirements of § 143-318.2(b)(2).

14. N.C. GEN. STAT. § 143-318.2(c) (Interim Supp. 1978) exempts meetings of the professional staff of a public body, unless the staff is a public body established by appropriate formal action described in § 143-318.2(b)(2). The report of the legislative study commission, in reference to this section, gives the following example: A monthly meeting of a county manager with his department heads or a conference between a director of a state division and two or three assistants could be held in private. If a city council, however, established a standing committee of four department heads to review federal grant requests originating within city government, meetings of that committee would be subject to the open meetings requirement. REPORT OF THE LEGISLATIVE STUDY COMMISSION, *supra* note 10, at 6.

15. N.C. GEN. STAT. § 143-318.4(4) (Interim Supp. 1978). A new provision also specifies that any public body specifically authorized by law to meet in executive or confidential session may do so. *Id.* § 143-318.4(11).

16. N.C. GEN. STAT. § 7A-377(a) (Cum. Supp. 1977).

17. Like North Carolina, other states have recently amended their open meetings laws to include provisions for notice. *See* S.C. CODE § 30-4-80 (Cum. Supp. 1978); W. Va. CODE § 6-9A-3 (Cum. Supp. 1978). Only a few states—Alabama, Colorado, Florida, Georgia, Minnesota, Montana, North Dakota and South Dakota—still have no notice provision. *See* ALA. CODE tit. 13, § 5-1 (1975); COLO. REV. STAT. § 29-9-101 (1977); FLA. STAT. ANN. § 286.011 (West 1975 & Supp. 1978); GA. CODE ANN. § 40-3301 (1975 & Supp. 1978); MINN. STAT. ANN. § 471-705 (West 1977); MONT. REV. CODES ANN. §§ 82-3401 to -3406 (1966 & Supp. 1977); N.D. CENT. CODE § 44-04-19 (1978); S.D. COMPILED LAWS ANN. §§ 1-25-1 to -5 (1974). The Supreme Court of Minnesota, however, has read into its open meetings law an implied provision for notice, *see* Sullivan v. Credit River Township, 299 Minn. 170, 217 N.W.2d 502 (1974), and the Attorney General of Florida has stated that some regulatory boards are required to give notice of all meetings at which official action is to be taken, *see* FLA. STAT. ANN. § 286.011 note 10 (West 1975)(citing Op. Att'y Gen. 072-400 (1972)).

law would not afford the protection it was intended to offer,¹⁸ both the majority and the dissent in *Byrd* agreed that no notice was required.¹⁹ The new law requires those public bodies that have established a schedule of regular meetings to keep the schedule on file in a central location.²⁰ If a regular meeting is adjourned or recessed until a later date, however, no further notice is required if the time and place of the later meeting is announced at the first session.²¹ Special meetings (a category that appears to include the meetings of those bodies that hold regular meetings on indefinite dates) require at least forty-eight hours notice by posting an announcement in a specified place and mailing or delivering it to any local news medium that has filed a prior written request for notice.²² Finally, emergency meetings, called because of unexpected circumstances that require immediate consideration, may be held as soon as members can be contacted and convened and notice is given to local news media that have requested emergency notice.²³

18. See, e.g., *News & Observer Publishing Co. v. Interim Bd. of Educ.*, 29 N.C. App. 37, 223 S.E.2d 580 (1976); *Weathers v. Shelby Bd. of Alcoholic Control*, 75 CVS 290 (Cleveland County, N.C. Super. Ct., July 16, 1975).

19. 293 N.C. at 596, 239 S.E.2d at 418; *id.* at 616, 239 S.E.2d at 429 (Exum, J., dissenting). Their reasoning was based on the lack of a notice provision.

20. N.C. GEN. STAT. § 143-318.8(a) (Interim Supp. 1978). State agencies file their schedules with the Secretary of State; county agencies, with the clerk of the board of county commissioners; city agencies, with the city clerk; and all other agencies, with their own clerk, secretary, or clerk to the board of commissioners in the county in which the agency normally meets. *Id.*

21. *Id.* § 143-318.8(b)(1).

22. *Id.* § 143-318.8(b)(2).

23. *Id.* § 143-318.8(b)(3). Notice is given either by telephone or by the same method used in notifying the body's members and must be given immediately after the members have been notified. In addition, only business related to the emergency can be considered at an emergency meeting. *Id.*

While the changes in the statute are consistent with the purpose underlying open meetings laws of providing public access to governmental decisionmaking processes, there are still other provisions lacking in clarity that seem to undercut this purpose. In 1978, for example, the North Carolina Court of Appeals held in *Godsey v. Poe*, 36 N.C. App. 682, 245 S.E.2d 522 (1978), that a board of education could hold a closed meeting to discuss personnel matters without first voting to do so in regular open session. The holding was dictated by the curious wording of a provision in the Open Meetings Law. The introductory language of N.C. GEN. STAT. § 143-318.3(a) (Interim Supp. 1978) sets out a procedure for calling executive sessions that requires a board to vote first to do so during a regular or special meeting. The subsection, however, lists only certain subject matters allowed under the statute to be discussed privately. The remainder of the subjects that may be discussed in a private meeting, including personnel matters, are set out in *id.* § 143-318.3(b), (c) (1978 & Interim Supp. 1978), to which the procedure of subsection (a) does not apply. As a result, meetings concerning subjects listed in subsections (b) and (c), unlike those concerning subjects listed in subsection (a), can be held with no public evidence that they ever occurred. A revision of the Open Meetings Law now pending in the General Assembly, however, does away with this distinction and requires a board to vote during its regular session to hold a closed meeting prior to discussing all matters allowed to be discussed in private. H. 183, N.C. Gen. Assembly, 1979 Sess.

B. Campaign Finance

The North Carolina campaign finance laws were interpreted for the first time in *Loucheim, Eng & People, Inc. v. Carson*,²⁴ a civil case involving an alleged illegal corporate expenditure. G.S. 163-278.19 (a),²⁵ a criminal statute, makes it unlawful for a corporation to make to a candidate any contribution or expenditure, both of which are defined to include an advance.²⁶ In *Carson*, plaintiff, a public relations corporation hired by state attorney general candidate James H. Carson, Jr., sued to recover over \$20,000 that Carson allegedly owed it from his unsuccessful campaign.²⁷ Plaintiff claimed that, as media campaign manager, it had been authorized by Carson and his staff to do everything necessary to handle the media portion of the campaign, and had been assured by Carson that it would be paid fully for all services rendered and money advanced. Plaintiff further asserted that in reliance on these assurances, it had rendered full services to Carson, including advancing money for purchases pending receipt by the committee of campaign funds.²⁸ In defense, Carson argued that the debt was an illegal advance within the scope of G.S. 163-278.19(a) and thus should not be honored as a contractual obligation.²⁹ The trial court granted Car-

24. 35 N.C. App. 299, 241 S.E.2d 401 (1978).

25. N.C. GEN. STAT. § 163-278.19(a) (1976) provides that, in general:

[I]t shall be unlawful for any corporation, business entity, labor union, professional association or insurance company directly or indirectly;

(1) To make any contribution or expenditure . . . in aid or in behalf of or in opposition to any candidate or political committee in any election or for any political purpose whatsoever

26. *Id.* § 163-278.6(6), (9) (1976). The statutes interpreted in *Carson* are identical in language to the provisions of the Federal Campaign Finance Law that prohibit corporate contributions and expenditures, *see* 2 U.S.C.A. § 441(b) (West Cum. Supp. 1977), and define them to include an advance, *see id.* § 431(e), (f). While there have been many cases interpreting the federal statute, *see, e.g.*, *United States v. Lewis Food Co.*, 366 F.2d 710 (9th Cir. 1966); *United States v. Chestnut*, 394 F. Supp. 581 (S.D.N.Y. 1975), *aff'd*, 533 F.2d 40 (2d Cir. 1976); *Miller v. American Tel. & Tel. Co.*, 394 F. Supp. 58 (E.D. Pa. 1975), *aff'd*, 530 F.2d 964 (3d Cir. 1976); *United States v. First Nat'l Bank*, 329 F. Supp. 1251 (S.D. Ohio 1971), none of these cases involved the same issue as presented in *Carson*, *i.e.*, whether a campaign finance law that prohibits corporate contributions and expenditures, including advances, precludes a candidate's corporate media manager from paying for the candidate's advertising and later seeking reimbursement.

27. 35 N.C. App. at 300-01, 241 S.E.2d at 403. The candidate had from time to time paid portions of the amounts outstanding. The remaining outstanding amount was \$22,251.65, which included \$10,000 that the candidate had paid by a check that was returned because of insufficient funds. *Id.* at 301, 241 S.E.2d at 403.

28. *Id.* at 301, 303-04, 241 S.E.2d at 403-04.

29. *Id.* at 302, 241 S.E.2d at 403. Carson also filed a counterclaim, alleging that plaintiff damaged his reputation in the amount of \$50,000 by knowingly and wilfully violating the law in arranging an unlawful extension of credit. The trial court's judgment did not dispose of defendant's counterclaim. *Id.*, 241 S.E.2d at 403-04.

son's motion for judgment on the pleadings.³⁰

In affirming, the court of appeals held that the money the corporation advanced to the various media for advertising purchases under its contract to manage the candidate's media campaign was the type of advance the law was aimed to prevent and that, therefore, it could not enforce the contract between the corporation and Carson for payment.³¹ In answer to plaintiff's contention that "advance" so construed would prohibit normal credit transactions between corporation and candidate, the court found that this payment for media advertising was not typical of ordinary extensions of credit, which are not barred by the statute.³² The court, however, suggested that the part of the debt representing plaintiff's commissions might be recovered if the commissions were not earned by plaintiff in connection with the other illegal advancements.³³

The court's application of a broad definition of advance in a context in which the corporation is, in essence, an agent of the candidate rather than an independent contributor, should be carefully scrutinized in light of the policies of the campaign finance laws. The purpose of these laws prohibiting corporate contributions and expenditures is twofold: to prevent corporate influence over elections; and to protect shareholders from the use of corporate funds for a political purpose without their consent.³⁴ There is, however, a countervailing concern that must be dealt with when, as here, the corporation is not unconnected with the candidate but, to the contrary, has been hired by him to render services. As has been recognized in the context of banks loaning money to candidates,³⁵ the statute cannot unconstitutionally intrude into normal business transactions. The Federal Election Commission,

30. *Id.*

31. *Id.* at 304, 307, 241 S.E.2d at 405, 406.

32. *Id.* at 305, 241 S.E.2d at 405. In drawing a distinction between ordinary and extraordinary extensions of credit, the court also rejected plaintiff's argument that the campaign finance laws infringed its right to contract and to carry on a lawful business in violation of the due process clause of the United States Constitution and the law of the land clause of the North Carolina Constitution. *Id.* at 306-07, 241 S.E.2d at 405-06. For a suggestion that the statute may be unconstitutional on these grounds, see this Survey, *Constitutional Law: Fourteenth Amendment: Due Process*.

33. *Id.* at 306-07, 241 S.E.2d at 406. Work done on a commission basis appears to be a prime example of a transaction involving an ordinary extension of credit.

34. See, e.g., *Miller v. American Tel. & Tel. Co.*, 394 F. Supp. 58 (E.D. Pa. 1975), *aff'd*, 530 F.2d 964 (3d Cir. 1976).

35. In *United States v. First Nat'l Bank*, 329 F. Supp. 1251 (S.D. Ohio 1971), the court held that when construed to prohibit a bank from making a fully secured loan to a candidate the statute violated the fifth amendment by intruding unnecessarily into the bank's ordinary course of business.

in carrying out the provisions of a federal statute that also prohibits advances by corporations,³⁶ has attempted to deal with this problem in the following regulation:

A corporation may extend credit to a candidate, political committee, or other person in connection with a Federal election provided that the credit is extended in the ordinary course of the corporation's business and the terms are substantially similar to extensions of credit to nonpolitical debtors which are of similar risk and size of obligation³⁷

Although the court in *Carson* relied heavily on federal authority,³⁸ it made no reference to this regulation and applied its interpretation of the state law prohibiting corporate advances in a manner inconsistent with the regulation. While recognizing that ordinary, as opposed to extraordinary, extensions of credit are not barred by the statute, the court did not, as the federal regulation appears to contemplate, remand the case for an examination of the ordinary business practices of public relations corporations nor remand to determine what the ordinary business practices of this particular corporation were.³⁹ Instead, the court concluded that plaintiff had violated the campaign finance law simply on the basis of inferences drawn from certain language in plaintiff's complaint. Plaintiff stated in its complaint that it had "advanced money" for the purchase of advertising⁴⁰ and that "defendant knew that the media advertising had to be currently paid and was aware of the [campaign] laws and regulations concerning media expenses."⁴¹ From this the court concluded that plaintiff was also aware that "in paying the defendant's expenses, it was going beyond the mere extension of credit."⁴² A plaintiff's interpretation of the law, however,

36. 2 U.S.C.A. § 441(b) (West Cum. Supp. 1977).

37. 11 C.F.R. § 114.10 (1977).

38. 35 N.C. App. at 304, 241 S.E.2d at 404-05.

39. If a particular firm, however, extends credit in such a manner to candidates and non-candidates alike, then there is no reason to believe the firm is trying to buy political favors—the concern behind the enactment of the statute prohibiting corporate advances.

40. 35 N.C. App. at 301, 241 S.E.2d at 403.

41. *Id.* at 305, 241 S.E.2d at 405. It is unclear to what laws and regulations plaintiff was referring. There are apparently no other laws or regulations prohibiting a public relations firm from "advancing" payment for a candidate's advertising.

42. *Id.* It is interesting to note that the former North Carolina Attorney General was apparently also in violation of the statute, since the statute also prohibits candidates from accepting illegal contributions or expenditures and subjects them to the same penalties as the donor. See N.C. GEN. STAT. § 163-278.19(c) (1976). The court implicitly recognized the candidate's situation in its statement that "we regard the worthless check [with which Carson had attempted to pay part of the debt] as nothing more than an acknowledgment by the defendant that the plaintiff had advanced money in his behalf," but went on to classify that acknowledgment as only a moral obligation that the defendant felt compelled to fulfill. 35 N.C. App. at 305, 241 S.E.2d at 405.

should not serve as a substitute for reasoned legal analysis.

The danger in the court's analysis is that it fails to recognize the practicalities in rendering services to a candidate. A public relations firm, as an agent of the candidate, manages the media portion of his campaign—an expensive undertaking for which the candidate must usually pay in periodic installments. In determining whether a particular "advance" by a public relations firm to a candidate is the type of activity that the law aims to prevent, the courts should take into account this practicality and examine whether a firm's particular extension of credit to a political candidate is consistent with normal business practices.

C. Regulation of Utilities⁴³

In 1978 the courts were faced with litigation arising out of the natural gas shortage that first affected the nation in the early 1970's.⁴⁴ Influenced primarily by the severity of natural gas curtailments to North Carolina,⁴⁵ the North Carolina Supreme Court in *State ex rel. Utilities Commission v. Edmisten*⁴⁶ upheld a Utilities Commission rule allowing

43. In *In re Duke Power Co.*, 37 N.C. App. 138, 245 S.E.2d 787, cert. denied, 295 N.C. 646, 248 S.E.2d 257 (1978), the court of appeals upheld a Utilities Commission order in the face of an environmental challenge to Duke Power Company's proposed construction of a nuclear power plant along the Yadkin River. Based on findings of the need for additional electrical capacity and of the appropriateness of the proposed plant's site and design, the Commission in 1977 granted Duke a certificate of public convenience and necessity (a prerequisite to most utility construction) for the building of a nuclear generating plant. The certificate, however, imposed limitations on the use of water from the Yadkin River, including the requirements that Duke receive construction and operating licenses from the Nuclear Regulatory Commission and the North Carolina Department of Natural and Economic Resources and that its operations be subject to periodic review by the Environmental Management Commission. *Id.* at 139-40, 245 S.E.2d at 789-90.

Petitioner, a nonprofit corporation "organized to promote recreational benefits and property values," *id.* at 139, 245 S.E.2d at 789, in an area downstream from the proposed plant site, was allowed to intervene in the Commission's hearings and appealed the granting of the certificate on the ground that flaws in the plant's design and placement that would cause pollution of the river and consume too much of its water were not adequately taken into account. The court, however, was satisfied that the Commission considered all facts required by law and issued an order supported by substantial evidence. *Id.* at 142, 245 S.E.2d at 791. Stating that the purpose of requiring the certificate—to prevent costly overbuilding—leaves environmental concerns to other agencies except as they affect the cost and efficiency of a proposed plant, *id.* at 141, 245 S.E.2d at 791, the court found that the limitations contained within the certificate evidenced the Commission's concern for the quality of water in the Yadkin River, *id.* at 142, 245 S.E.2d at 791. In addition, the court disposed of petitioner's arguments based on the legal rights of riparian owners by declaring that no "taking" of property rights had occurred. *Id.*

44. See Harrison & Formby, *Regional Distortions in Natural Gas Allocations: A Legal and Economic Analysis*, 57 N.C.L. REV. 57, 61 (1978).

45. Next to South Carolina, North Carolina experienced more severe curtailments than any other state. See Harrison & Formby, *supra* note 44, at 84-85.

46. 294 N.C. 598, 242 S.E.2d 862 (1978).

state natural gas distributors to engage in exploration and development programs for new gas supplies and to pass the costs of these programs directly to their customers in the form of rate increases.⁴⁷

In *Edmisten*, the attorney general of North Carolina argued that the Commission exceeded its statutory authority in allowing the costs to be charged as operating expenses of the utility, thereby permitting them to be passed directly to the consumer without the necessity of a general ratemaking hearing.⁴⁸ Such an accounting procedure, he maintained, assigns a function to the operating expense that it was not intended to bear—attraction of capital—and thus shifts the risks of gas exploration from willing investors to the consuming public.⁴⁹ The attorney general proposed that the costs of the programs should have been financed instead out of retained earnings or otherwise, and recouped through a variation in the utility's rate base,⁵⁰ a procedure that would require a general ratemaking proceeding to determine whether the net profits in comparison with the rate base allow the utility a "fair rate of return."⁵¹

Relying on the Commission's unchallenged findings of fact that natural gas utilities needed additional supplies to render adequate service, that exploration programs were the most feasible means of obtaining supplies, and that the programs could not be financed through traditional methods,⁵² the court held that the Commission acted within the authority granted it by the legislature⁵³ to promote adequate, eco-

47. *Id.* at 612, 242 S.E.2d at 871.

48. *Id.* at 603, 242 S.E.2d at 866. By statute, a utility is allowed a "fair rate of return" on the value of its property that is "used and useful" in rendering service to the public. N.C. GEN. STAT. § 62-133(b) (1975). The rate of return may be represented by the formula $r = (R - E) \div V$, in which r is the rate of return expressed as a percentage, R is the revenues obtained from rates, E is the operating expenses, and V is the value of the utility's depreciated property, or what is more commonly known as the rate base. See E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* 52-53 (1950); see also N.C. GEN. STAT. § 62-133 (1975 & Cum. Supp. 1977). An increase in operating expenses can be accompanied by a proportionate increase in rates without disturbing the rate base and rate of return, and thus, a general ratemaking hearing will not be required. See N.C. GEN. STAT. § 62-137 (1975). Another way of accounting for costs is by ascertaining the value of the property a utility is currently using, which will be attributed to the rate base, and the operating expenses incurred in using that property. These factors are then considered in determining the amount of an increase in revenues that will produce a fair rate of return. Because all factors in the rate structure are affected by this method of accounting, a general ratemaking hearing is required. See *id.* §§ 62-133, -137.

49. 294 N.C. at 604-05, 242 S.E.2d at 867.

50. *Id.* at 603, 242 S.E.2d at 866.

51. See note 48 *supra*. The net profits are represented in the formula by the factor $R - E$ (the difference between revenues and operating expenses).

52. 294 N.C. at 605-06, 242 S.E.2d at 867.

53. See N.C. GEN. STAT. §§ 62-2, -32, -42, -131(b) (1975 & Cum. Supp. 1977).

nomical, and efficient utility services and to render reliable supplies.⁵⁴ It further found that a strict interpretation of the operating expense element of the ratemaking formula "would severely limit the ability of the Commission to act in the best interest of the consuming public in emergency situations."⁵⁵ In a strong dissent,⁵⁶ Justice Lake argued that the Commission had no authority "to conscript capital from unwilling investors . . . in order to finance a . . . prospecting venture"⁵⁷ because the definition of public utility—"a person . . . owning or operating in this State equipment or facilities for . . . [p]roducing, generating, transmitting, delivering or furnishing . . . piped gas"⁵⁸—does not include the business of prospecting or exploring for natural gas, particularly when conducted in another state.⁵⁹

Although the distinction between production and exploration may be too slight to negate the Commission's authority to regulate development of gas resources, the scope of the Commission's authority should not go unscrutinized. The majority's opinion is an example of result-oriented reasoning; a contrary result could have just as easily been reached had the court not been so willing to label the costs of development as operating expenses.⁶⁰ Indeed, capital investment is not nor-

54. 294 N.C. at 606, 242 S.E.2d at 868.

55. *Id.* at 607, 242 S.E.2d at 868. The court also rejected the attorney general's contentions that the proceedings in which various utility companies were allowed specific rate increases to account for the costs of exploration should have been declared to be general rate cases, and that the failure to do so prejudiced him because it obviated the necessity for the special procedures provided in N.C. GEN. STAT. § 62-81 (Cum. Supp. 1977). Characterizing the rate increases as "permitted" or "allowed" rates that, pursuant to N.C. GEN. STAT. § 62-134(a) (1975), are allowed to go into effect for good cause without a hearing, the court found good cause for the increases in the Commission's determination, pursuant to the standards set out in its rule allowing such increases, that the adjustment would not raise the utility's rate of return above the level most recently approved in a general rate case. 294 N.C. at 609-10, 242 S.E.2d at 869. The court found the attorney general was not prejudiced because N.C. GEN. STAT. § 62-132 (1975) subjects these "permitted" or "allowed" rates to later challenge by any interested person, and provides for a hearing on their "just and reasonable" nature. 294 N.C. at 609-10, 242 S.E.2d at 869-70. In addition, the court rejected the attorney general's arguments that the orders violated the due process and equal protection clauses of the United States and North Carolina constitutions. *Id.* at 610-12, 242 S.E.2d at 870-71.

56. The language used by Justice Lake is indeed strong. For example, see his characterization of the facts of the case at *id.* at 616-18, 242 S.E.2d at 873-74 (dissenting opinion).

57. *Id.* at 622, 242 S.E.2d at 876.

58. N.C. GEN. STAT. § 62-3(23)a.1. (Cum. Supp. 1977).

59. 294 N.C. at 618-22, 242 S.E.2d at 874-76.

60. In so labeling these costs, the court relied on a 1935 Arkansas opinion, which stated that when a restrictive interpretation of the operating expense element of an act would frustrate the act's purposes, the element should be given a liberal construction. *Id.* at 606, 242 S.E.2d at 868 (citing *Bourland v. City of Fort Smith*, 190 Ark. 289, 78 S.W.2d 383 (1935)). The court could just as easily have relied on its own language in *Little v. Stevens*, 267 N.C. 328, 148 S.E.2d 201 (1966): "If an act is susceptible to more than one construction, the consequences of each are a potent

mally associated with operating expenses; however, the court felt justified in holding that operating expenses were involved because of the abnormal emergency situation. As a short-term measure, allowing utilities to meet a present emergency by a direct increase in rates may be necessary. Exploration and development, however, is not a short-term solution⁶¹ to a temporary crisis but rather a long-term approach to a continuing need for energy supplies. Because of this continuing "emergency," utility companies that have traditionally been engaged solely in the business of distributing energy may be permitted in the future to engage more and more in exploration and development programs at no risk to themselves. In such a situation, the attorney general's proposal requiring general ratemaking proceedings to determine whether a utility should be allowed an increase in rates may be necessary in order to curtail abusive spending. Such a proposal appears to be a valid compromise: by allowing the utility to calculate the costs of exploration and development programs into its rate base, the risks involved in the programs are still shifted to the consumer, but only after public scrutiny of the utility's fair rate of return.

In *State ex rel. Utilities Commission v. Public Service Co.*,⁶² the court of appeals approved a Commission order establishing a new method for adjusting utility rates to reflect the curtailment of natural gas supplies.⁶³ Because curtailment levels had fluctuated making it impossible accurately to predict future revenues and expenses, the Commission authorized Public Service Company's use of a formula known as the Volume Variation Adjustment Factor (VVAF). The VVAF is a rate set for the future, based on projected volumes of gas, that is designed to track the effects of increased or decreased curtailment on revenues and avoid the necessity for a general rate case each time curtailment levels change.⁶⁴

In June 1976, Public Service sought to revise upwards the VVAF factor it had submitted less than a month earlier. The factor first submitted reflected a curtailment estimate based upon five and one-half months of historical supply levels and six and one-half months of fore-

factor in its interpretation, and undesirable consequences will be avoided if possible." *Id.* at 336, 148 S.E.2d at 207.

61. In contrast, North Carolina's purchase of large volumes of emergency gas during the winter of 1977-1978, see Harrison & Formby, *supra* note 44, at 79 n.160, was a short-term response to the curtailment problem.

62. 35 N.C. App. 156, 241 S.E.2d 79 (1978).

63. *Id.* at 162, 241 S.E.2d at 83.

64. *Id.* at 156-57, 241 S.E.2d at 80.

casted future supplies, while the June revision was calculated on the basis of annualizing the upcoming summer period curtailment level. Although the Commission had apparently approved use of either method, it changed its mind after the attorney general intervened on behalf of the using and consuming public and filed a motion to rescind approval of the June rate increase.⁶⁵ Following a hearing on the matter, the Commission concluded that the historical/future method should serve as the basis for the VVAF calculation and should be "trued-up" periodically to account for the actual curtailment experienced. It ordered that the difference between the rate in effect and the "true" rate be refunded to customers and applied this order to the revised June VVAF factor, which had been employed in calculating Public Service's rates pending termination of the hearing.⁶⁶

On appeal, Public Service argued that the refund provisions exceeded the authority of the Commission because they constituted retroactive ratemaking, and proposed that instead of refunding it should be allowed to "true-up" by offsetting its new VVAF.⁶⁷ While retroactive changes in existing rates are not allowed,⁶⁸ the court concluded that the VVAF is not an established rate but rather a permitted or allowed rate under G.S. 62-132⁶⁹ that can be subject to refund upon a determination by the Commission that it is unjust and unreasonable.⁷⁰ In rejecting Public Service's proposal, the court accurately pointed out that, unlike the Commission order, the proposal would benefit only those who remained Public Service customers—a group that may not include all who paid the higher amounts.⁷¹

Another issue arising in the public utility context was whether a two-way radio service offered to members of a county medical society as an adjunct to a telephone answering service is a "public utility" within the meaning of G.S. 62-3⁷² and thus subject to regulation by the Utilities Commission. In *State ex rel. Utilities Commission v. Simpson*,⁷³ the supreme court affirmed a Commission ruling that the service is a public utility. The decision turned on whether the service was of-

65. *Id.* at 157-58, 241 S.E.2d at 80.

66. *Id.* at 158, 241 S.E.2d at 81.

67. *Id.* at 160-61, 241 S.E.2d at 82.

68. *See, e.g., State ex rel. Utils. Comm'n v. Edmisten*, 291 N.C. 451, 468, 232 S.E.2d 184, 194 (1977).

69. N.C. GEN. STAT. § 62-132 (1975).

70. 35 N.C. App. at 161, 241 S.E.2d at 82.

71. *Id.*, 241 S.E.2d at 83.

72. N.C. GEN. STAT. § 62-3(23) (Cum. Supp. 1977).

73. 295 N.C. 519, 246 S.E.2d 753 (1978).

ferred to the "public"—a term that the court noted "'does not mean everybody all the time.'" ⁷⁴ Although an earlier North Carolina case had held that a two-way radio service offered to anyone who applies for it is "offered to the public," ⁷⁵ *Simpson* was more complicated because the class to whom the service was offered consisted only of physicians within one county; however, because the class comprised approximately one-half of the radio communications market in the county, the court found that regulation of the service as a public utility was proper. ⁷⁶ In light of the court's admission that a determination of whether a service is offered to the public is difficult to standardize and must often be made by resort to the facts of a particular case, ⁷⁷ the decision may prove to be of little guidance in delineating the point at which a private enterprise becomes subject to regulation as a public utility.

A final issue affecting utilities involved the continued vitality of the common law rule that a privately owned utility is required to remove or relocate its facilities along a public street at its own expense when necessary for the public use and convenience. ⁷⁸ In *Southern Bell Telephone & Telegraph Co. v. Housing Authority*, ⁷⁹ the court of appeals confronted the issue, raised in North Carolina for the first time, whether state urban redevelopment laws mandate a result contrary to the common law when a telephone company is compelled by a city to relocate its telephone lines from an area undergoing urban redevelopment. The court refused to depart from the common law rule. ⁸⁰

The court observed that reimbursement might be authorized by the urban redevelopment statutes in two possible ways: (1) as compensation for an eminent domain taking under G.S. 160A-512(6), ⁸¹ or (2) because the cost of removal is an expenditure necessary to carry out the purposes of the Urban Redevelopment Law ⁸² under G.S. 160A-

74. *Id.* at 522, 246 S.E.2d at 755 (quoting *Terminal Taxicab Co. v. Kutz*, 241 U.S. 252, 255 (1916)).

75. *State ex rel. Utilities Comm'n v. Carolina Tel. & Tel. Co.*, 267 N.C. 257, 148 S.E.2d 100 (1966).

76. 295 N.C. at 525, 246 S.E.2d at 757.

77. *Id.* at 524, 246 S.E.2d at 756.

78. See 39A C.J.S.2d *Highways* § 139c (1976).

79. 38 N.C. App. 172, 247 S.E.2d 663 (1978), *cert. denied*, 296 N.C. 414, 251 S.E.2d 473 (1978).

80. *Id.* at 176, 247 S.E.2d at 667.

81. N.C. GEN. STAT. § 160A-512(6) (1976).

82. *Id.* §§ 160A-500 to -526.

512(11)⁸³ and thus an expenditure that a city's urban redevelopment commission is empowered to make.⁸⁴ Finding that Southern Bell had no property or interest in the land upon which its facilities were located, the court held that there was not a taking, and noted that, even if there were, the situation is analogous to cases in which a leasehold is condemned and the tenant is required to pay his own relocation costs.⁸⁵ On the issue of whether the removal and relocation costs were necessary expenditures under the Urban Redevelopment Law, the court simply indicated that absent specific legislative language, it felt compelled to adhere to the established result.⁸⁶

The court's observation that reimbursement would be authorized if the cost of removal were an expenditure necessary to carry out the purposes of the Redevelopment Law does not take into account the ultimate question whether a statutory authorization to make such an expenditure precludes an urban redevelopment commission from requiring the public utility to bear the expense. Arguably, according to the court's analysis, reimbursement should be authorized on the ground that because the power to remove utility lines is by statutory definition a power necessary to carry out the Act's purposes⁸⁷ (and thus a power that the commission can exercise), then an expenditure pursuant to that power is also necessary to carry out the Act's purposes. Nevertheless, the court failed to reach this result, maintaining in a conclusory statement that "we cannot hold Southern Bell's relocation expenses to be 'necessary expenditures' . . . since at common law no such reimbursement was required."⁸⁸ It is possible, however, that the legislature's grant of power to an urban redevelopment commission to make necessary expenditures, which as illustrated include those for the removal of utility lines, indicates an intent to alter the common law.

*D. State and Local Government*⁸⁹

1. State Employees

The 1978 General Assembly passed two statutes that will have an

83. *Id.* § 160A-512(11) (1976).

84. *Id.* § 160A-512 (1976); 38 N.C. App. at 174, 247 S.E.2d at 665.

85. 38 N.C. App. at 174, 247 S.E.2d at 666. See, e.g., *Williams v. State Hwy. Comm'n.* 252 N.C. 141, 113 S.E.2d 263 (1960).

86. 38 N.C. App. at 176, 247 S.E.2d at 667.

87. N.C. GEN. STAT. § 160A-512(11) (1976).

88. 38 N.C. App. at 176, 247 S.E.2d at 666.

89. The General Assembly took action this year to limit public access to the State Bank Commissioner's records. See Law of June 16, 1978, ch. 1181, 1977 N.C. Sess. Laws, 2d Sess. 1978.

important effect on state employees. The more significant statute eliminates automatic wage increases for state employees and replaces them with increases based on merit.⁹⁰ In the past, North Carolina has taken a compromise position on wage increases; employees at lower levels were granted automatic increases and those at higher levels received increases based on performance.⁹¹ In theory, at least, the elimination of automatic increases is an attempt to promote efficiency and productivity in government through a salary incentive.⁹² Because there are numerous ways to circumvent such a statute,⁹³ however, it remains to be seen whether the goal will be accomplished.

In addition, the State Personnel Privacy Act⁹⁴ was amended⁹⁵ to allow state department heads to make public the reasons why an employee was demoted, suspended or dismissed and to allow public access to that employee's personnel file.⁹⁶ Although the date on which the

at 70 (codified at N.C. GEN. STAT. §§ 53-99, -117 (Interim Supp. 1978)). An interim measure that expires on June 30, 1979, the new Act provides that records compiled during state and federal banking examinations, borrowers' records, and records containing information compiled in preparation or anticipation of litigation are not subject to public inspection. N.C. GEN. STAT. § 53-99 (Interim Supp. 1978). Any letters, reports, memoranda, recordings, charts or other documents that would disclose the information in these confidential records are also confidential. *Id.*; Law of Apr. 2, 1931, ch. 243, § 10, 1931 Pub. Laws 301 (formerly codified at N.C. GEN. STAT. § 53-99 (1975)) (amended 1978). Prior to these amendments the statute was silent about what records were not available to the public. In addition, the legislature created a commission to study the area of access and confidentiality of the Bank Commissioner's and State Banking Commission's records. While the study commission has proposed in effect the retention of the recent restrictions, it has also recommended that reports containing information about "insider" transactions be subject to public inspection, see Proposed Bill of the Study Commission on Access to and Confidentiality of Banking Records (released February 7, 1979) (copy on file in office of *North Carolina Law Review*), an important provision in light of the numerous instances involving such transactions that have allegedly occurred in recent years. Congress recently enacted a similar statute regarding release of information about insider transactions that applies to any bank, whether state or national, insured by the Federal Deposit Insurance Corporation, Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, § 901, 92 Stat. 3641 (amending 12 U.S.C. § 1817).

90. Law of June 16, 1978, ch. 1213, 1977 Sess. Laws, 2d Sess. 1978, at 142 (codified at N.C. GEN. STAT. § 126-7 (Interim Supp. 1978)).

91. Law of May 20, 1965, ch. 640, 1965 N.C. Sess. Laws 711 (formerly codified at N.C. GEN. STAT. § 126-7 (Cum. Supp. 1977)) (amended 1978).

92. This was also the purpose behind the passage of the Civil Service Reform Act of 1978, considered to be the most extensive revamping of the federal employment scheme since the establishment of the Civil Service System approximately 100 years ago. See 36 CONG. Q. 2945 (1978). The Act provides for merit pay for employees at levels GS-13 through GS-15. Civil Service Reform Act of 1978, Pub. L. No. 95-454, § 5402, 92 Stat. 1111.

93. For example, job supervisors who perhaps feel that wage increases should be based on length of service could recommend merit increases without fully scrutinizing the performance of each employee.

94. N.C. GEN. STAT. §§ 126-22 to -29 (Cum. Supp. 1977).

95. Law of June 16, 1978, ch. 1207, 1977 Sess. Laws, 2d Sess. 1978, at 134 (codified at N.C. GEN. STAT. § 126-24 (Interim Supp. 1978)).

96. In order to release the information, the department head must first determine that the

action was taken is public information,⁹⁷ under the former law what an employee did to merit the action was not.⁹⁸ Prior to this amendment, an employee's statement was the only public information available. The new statute provides a means for testing the accuracy of employee statements and for providing the public with more complete information concerning the demotion, suspension or dismissal of public employees.

Also considered in 1978, in *Williams v. Greene*,⁹⁹ was the case of a dismissed state employee who brought a section 1983¹⁰⁰ action against his employer, the North Carolina Highway Patrol, in which he asked for a preliminary injunction to reinstate him to his position with back pay pending a hearing before the State Personnel Commission.¹⁰¹ A preliminary injunction is traditionally granted, pending trial on the merits, when there is probable cause to believe that plaintiff will be able to establish his case and when there is reasonable apprehension that he will suffer irreparable loss without it.¹⁰² In *Williams*, the court of appeals announced that the availability to plaintiff of an administrative remedy would be weighed heavily in determining if plaintiff will suffer irreparable loss.¹⁰³ Primarily because the State Personnel Commission could award *Williams* reinstatement and back pay,¹⁰⁴ the courts found

release of the information or the inspection and examination of the file is essential to maintaining the integrity of his department or to maintaining the level or quality of services provided by his department, and must prepare a supporting statement. *Id.*

97. N.C. GEN. STAT. § 126-23 (Cum. Supp. 1977).

98. Law of May 12, 1975, ch. 257, 1975 N.C. Sess. Laws 249 (formerly codified as amended at N.C. GEN. STAT. § 126-24 (Cum. Supp. 1977)) (amended 1978).

99. 36 N.C. App. 80, 243 S.E.2d 156, *appeal dismissed, cert. denied*, 295 N.C. 471, 246 S.E.2d 12 (1978).

100. 42 U.S.C. § 1983 (1976).

101. Plaintiff, a North Carolina Highway Patrolman, was involved in a roadblock incident in 1976 in which a Virginia State Patrolman, who was being held hostage, was killed. After an investigation of the incident by the State Department of Transportation, plaintiff was dismissed from his job on the grounds "that he was imprudent and careless in the use of his weapon . . . , that he jeopardized the safety of a hostage . . . by firing into a vehicle, and that he used excessive force while attempting to apprehend a dangerous criminal." 36 N.C. App. at 81-82, 243 S.E.2d at 157-58. Plaintiff promptly requested a hearing before the State Personnel Commission, but none had been scheduled as of the time he brought his lawsuit. *Id.* at 82, 243 S.E.2d at 158. In his suit, plaintiff averred that because of adverse publicity surrounding his dismissal, his professional reputation had been damaged and other job opportunities foreclosed, and that without reinstatement, irreparable injury to his reputation and livelihood would ensue. *Id.*

102. N.C.R. Civ. P. 65.

103. The court also held, consistent with the recent trend of authority, *see, e.g., McCray v. Burrell*, 516 F.2d 357, 365 (4th Cir. 1975), *cert. denied*, 426 U.S. 471 (1976), that a party suing under § 1983 does not have to exhaust his administrative remedies before seeking judicial relief. 36 N.C. App. at 85, 243 S.E.2d at 160.

104. The State Personnel Commission has the authority to grant reinstatement, back pay and attorneys' fees under N.C. GEN. STAT. §§ 126-4(9), -4(11) (Cum. Supp. 1977).

that he would not suffer irreparable loss of income.¹⁰⁵ In reversing a trial court order granting a preliminary injunction, the court, however, failed to analyze the issue of irreparable damage to plaintiff's reputation and simply concluded that "any damage to plaintiff's reputation . . . must be balanced against the possible harm to the state in retaining plaintiff on the North Carolina Highway Patrol."¹⁰⁶

2. Local Government

Numerous challenges to the powers of local government were considered by the courts in 1978.¹⁰⁷ In *In re Ordinance of Annexation No. 1977-4*,¹⁰⁸ a case of first impression, the North Carolina Supreme Court upheld the power of a city to annex federal property—a power that has been upheld in other jurisdictions in almost every instance in which it has been challenged.¹⁰⁹ The court noted that the only limitation on this power is that it be exercised in accordance with the state's statutes.¹¹⁰ Asserting that the city did not meet the latter requirement,¹¹¹ plaintiff argued that the statutory requirement that there be a

105. 36 N.C. App. at 86, 243 S.E.2d at 160.

106. *Id.*

107. In *Big Bear, Inc. v. City of High Point*, 294 N.C. 262, 240 S.E.2d 422 (1978), the supreme court upheld the validity of a city ordinance that required business operations to pay a fee for city garbage collection. Plaintiffs sued to recover fees they had paid in protest on the ground that the payments were coercive, and thus involuntary and illegal, because the city had threatened to discontinue service if payments were not made. Because a section of the ordinance allowed others to engage in garbage collection with the city's permission, the court concluded that plaintiffs were not forced to contract with the city, and thus required plaintiffs to pay fees for the city services they had voluntarily accepted. The holding comports with the decisions of many other states that have allowed municipalities, in exercising their police powers, and as incident to garbage regulations, to exact a fee for trash removal, and if reasonable, to charge a business a different rate from that charged to individuals. See, e.g., *Glass v. Fresno*, 17 Cal. App. 2d 555, 62 P.2d 765 (1936); *Mayor of Milledgeville v. Green*, 221 Ga. 498, 145 S.E.2d 507 (1965); *Walker v. Jameson*, 140 Ind. 591, 37 N.E. 402 (1894); *Harper v. Richardson*, 222 Mo. App. 331, 297 S.W. 141 (1927).

108. 296 N.C. 1, 249 S.E.2d 698 (1978). The case involved the City of Goldsboro's power to annex Seymour Johnson Air Force Base.

109. See, e.g., *Howard v. Commissioners of Louisville*, 344 U.S. 624 (1953); *Flynn v. Stevenson*, 4 Ill. App. 3d 458, 281 N.E.2d 438 (1972); *Kansas City v. Querry*, 511 S.W.2d 790 (Mo. 1974); *Wichita Falls v. Bowen*, 143 Tx. 45, 182 S.W.2d 695 (1944); *County of Norfolk v. City of Portsmouth*, 186 Va. 1032, 45 S.E.2d 136 (1947).

110. See *United States v. Bellevue*, 334 F. Supp. 881 (D. Neb. 1971), *aff'd*, 474 F.2d 473 (8th Cir.), *cert. denied*, 414 U.S. 827 (1973) (federal property could be annexed under state statute, but annexation violated statutory requirement that it not be for sole purpose of obtaining revenue).

111. Plaintiff, a resident of the annexed area, challenged the ordinance on numerous other grounds, including (1) that the annexation of federal property was beyond the powers delegated to the city by legislative authority; (2) that the annexation would allow imposition of an unconstitutionally unequal tax because military personnel are exempted from local taxation; and (3) that the annexation violated the purposes of the annexation statute because it was inconsistent with "sound urban development" as required by N.C. GEN. STAT. § 160A-45 (1976). 296 N.C. at 16-18, 249 S.E.2d at 707-08.

"total resident population" of two persons per acre of annexed land¹¹² was not met because military personnel, not subject to taxation in the annexing unit and thus not eligible to vote therein, were counted as residents.¹¹³ In rejecting plaintiff's argument, the court distinguished the words "residence" (a person's actual place of abode, whether permanent or temporary) and "domicile" (one's permanent, established home), and held that a finding of the latter was not required.¹¹⁴ A person is properly counted as a member of the "total resident population," the court held, if he would have been counted as an inhabitant of the area under rules governing the last federal census.¹¹⁵ Plaintiff also contended that the statutes were not followed because the city did not have funds budgeted to provide municipal services to the annexed area;¹¹⁶ however, the court pointed out that the clear intent of the statute is to require only that the city show how it will provide these services.¹¹⁷

The powers of a regional council of governments, a quasi-governing body composed of two or more units of local government,¹¹⁸ were considered for the first time in *Kloster v. Region D Council of Governments*,¹¹⁹ in which the court of appeals held that a council does not have the inherent authority to own real estate or construct an office building.¹²⁰ Defendant, a council of governments located in western North Carolina, received a federal grant that it used to purchase land. It planned to construct an office building on the land, partly for its own use and partly for rental purposes, and to use the profits from the building to establish a retirement fund for its employees. Because a state statute allows a council to occupy space provided by a member government at the latter's expense,¹²¹ the Council argued that it had the implied power to own and occupy a building constructed by funds from a

112. N.C. GEN. STAT. § 160A-48(c) (1976) requires that "part or all of the area to be annexed must be developed for urban purposes," and sets out as one of the standards for determining if this requirement has been met that the area have "a total resident population equal to at least two persons for each acre of land included within its boundaries"

113. 296 N.C. at 13-14, 249 S.E.2d at 705-06.

114. *Id.* at 15, 249 S.E.2d at 706.

115. *Id.* Authority for this method of estimating population is found in N.C. GEN. STAT. § 160A-54(1) (1976).

116. As a prerequisite to annexation, N.C. GEN. STAT. § 160A-47 (1976) requires, in part, that the municipality prepare a report that includes a statement of "the method under which the municipality plans to finance extension of services into the area to be annexed."

117. 296 N.C. at 16, 249 S.E.2d at 707.

118. See N.C. GEN. STAT. §§ 160A-470 to -478 (1976).

119. 36 N.C. App. 421, 245 S.E.2d 180, *cert. denied*, 295 N.C. 466, 246 S.E.2d 215 (1978).

120. Plaintiff, a local taxpayer, challenged the Council's authority. For a discussion of plaintiff's standing to bring suit, see this Survey, *Civil Procedure: Jurisdiction*.

121. N.C. GEN. STAT. § 160A-476 (1976).

federal grant it had received. G.S. 160A-475, however, allows only specific enumerated powers to be conferred on a regional council by charter, and allows member governments to delegate other powers to the council by resolution.¹²² Since the Council did not possess the power to own real estate or construct an office building by virtue of statutory or delegated authority, the court, considering these to be the exclusive means by which a regional council could obtain power, rejected defendant's theory of implied power.¹²³

In *Cooke v. Futrell*,¹²⁴ the court of appeals clarified the extent of a municipality's power to impose penalties for failure to pay a municipal license tax. The municipal resolution in question imposed a one dollar fine on motor vehicle owners who failed to purchase municipal license tags by a certain date. In construing the resolution to uphold its validity,¹²⁵ the court confined those vehicles subject to the municipal tax and penalty to only those previously licensed by the state. Plaintiff could not be forced to pay a municipal license tax penalty before his car was licensed by the state because, according to state law, the local license could not be required until the state had licensed the vehicle.¹²⁶ In reaching this construction, the court relied on two state statutes—G.S. 160A-206,¹²⁷ which gives cities the power to tax only as specifically provided by statute and gives them an inherent power to penalize along with a power to tax, and G.S. 20-97,¹²⁸ which authorizes cities and towns within certain counties to levy at most one dollar annually on the use of a vehicle licensed by the state.¹²⁹

122. *Id.* § 160A-475(1)-(8). Prior to 1975, the statute allowed councils powers other than those specifically set out without requiring that the member governments delegate these other powers; however, the council had applied for the federal grant after the new language requiring delegation was adopted. 36 N.C. App. at 429, 245 S.E.2d at 185.

123. *Id.* at 428-29, 245 S.E.2d at 184-85.

124. 37 N.C. App. 441, 246 S.E.2d 65 (1978).

125. Plaintiff alleged that the Town of Rich Square and its agent violated North Carolina statutory law as well as the North Carolina and United States constitutions, which protect against unjust taxation.

126. Because it was unclear whether, when plaintiff purchased his state tags the day after he paid the penalty, this was a new license or delinquent renewal, the court remanded the case for a factual finding. *Id.* at 443-44, 246 S.E.2d at 66-67.

127. N.C. GEN. STAT. § 160A-206 (1976) provides in part:

A city shall have power to impose taxes only as specifically authorized by act of the General Assembly. Except when the statute authorizing a tax provides for penalties and interest, the power to impose a tax shall include the power to impose . . . penalties or interest for failure to pay taxes lawfully due within the time prescribed by law or ordinance.

128. *Id.* § 20-97 (1978).

129. 37 N.C. App. at 443, 246 S.E.2d at 66.

E. Unemployment Compensation

With its decision in *In re Sarvis*,¹³⁰ the North Carolina Court of Appeals established that striking employees who offer to return to work but have been replaced by permanent employees are not necessarily barred from unemployment benefits.¹³¹ The issue in *Sarvis* centered on an interpretation of G.S. 96-14(5)¹³² that disqualifies an employee from benefits during any week in which his unemployment "is caused by a labor dispute in active progress." In reversing the trial court's conclusion that unemployment originally caused by a dispute is not changed in respect of its cause by subsequent events, the court focused on the words "active progress" in the statute and the decisions of other states that have held a dispute terminated upon replacement of the employees and/or an unconditional offer to return to work.¹³³ The issue whether the dispute was still in progress was complicated, however, by the employees' filing, subsequent to their offer to return, of a petition for certification of a bargaining representative before the National Labor Relations Board. Holding that the dispute would be deemed over if the petition were found to be unrelated to the original strike,¹³⁴ the court remanded the case for a determination of this factual issue.¹³⁵

F. Liquor by the Drink

In 1978 the General Assembly passed legislation¹³⁶ to allow cities

130. 36 N.C. App. 476, 245 S.E.2d 176 (1978), *rev'd*, 296 N.C. 475, 251 S.E.2d 434 (1979).

131. Appellants, 16 employees of the High Point Sprinkler Company, struck the plant in a dispute over economic benefits and their employer's decision to transfer an employee. Shortly thereafter, the employer demanded that they return to work the following day or else permanent replacements would be sought. When the employees offered to return 4 days after the ultimatum, 14 of the 16 jobs had been filled. *Id.* at 477, 245 S.E.2d at 177.

132. N.C. GEN. STAT. § 96-14(5) (1975).

133. 36 N.C. App. at 477-78, 245 S.E.2d 176-79 (citing *Ruberoid Co. v. California Unemployment Ins. Appeals Bd.*, 59 Cal. 2d 73, 378 P.2d 102, 27 Cal. Rptr. 878 (1963); *Knight-Mortley Corp. v. Employment Sec. Comm'n.*, 352 Mich. 331, 89 N.W.2d 541 (1958); *Sprague & Henwood, Inc. v. Unemployment Compensation Bd. of Review*, 207 Pa. Super. 112, 215 A.2d 269 (1965); *Special Prods. Co. v. Jennings*, 209 Tenn. 316, 353 S.W.2d 561 (1964); *Texas Employment Comm'n. v. Hodson*, 346 S.W.2d 665 (Tex. Civ. App. 1961)). The supreme court agreed that unemployment is no longer caused by "a labor dispute in active progress" when employees offer to return to work. 296 N.C. at 481, 251 S.E.2d at 438.

134. The employees had also filed unfair labor practices charges before the NLRB that alleged discrimination in hiring and tenure in order to discourage membership in a labor organization; however, the court found these charges unrelated to the strike. 36 N.C. App. at 481-82, 245 S.E.2d at 179-80.

135. The supreme court, holding that the petition pending before the NLRB could not cause unemployment and thus could not serve as a basis for disqualifying employees from receiving benefits, reversed this holding of the court of appeals. 296 N.C. at 481-82, 251 S.E.2d at 437-38.

136. Law of June 15, 1978, ch. 1138, 1977 N.C. Sess. Laws, 2d Sess. 1978, at 36 (codified at

and counties with ABC stores to hold elections on the sale of mixed drinks in restaurants¹³⁷ and social establishments.¹³⁸ The bill as finally adopted prohibits "brown-bagging" in restaurants located in cities or counties that have approved mixed drink sales, raises the tax on liquors from five dollars to ten dollars a gallon, and provides that nine dollars of the tax will go to the local unit while one dollar will go to alcoholism treatment and research.

The regulations concerning mixed drinks,¹³⁹ promulgated by the State ABC Board in conjunction with a special advisory committee, allow hotels with restaurants to apply for a permit¹⁴⁰ and allow qualified restaurants¹⁴¹ and hotels to operate a lounge separate from the dining area.¹⁴² Strict regulations have been adopted to ensure that a "social establishment" is bona fide, that is, not open to the general public, including the requirement that it have a thirty-day waiting period for membership.¹⁴³

N.C. GEN. STAT. §§ 18A-2, -8, -15, -25, -29 to -31, -40, -51, -54 (Interim Supp. 1978)) (repealing N.C. GEN. STAT. § 18A-13).

137. A restaurant is required to be "engaged primarily and substantially in preparing and serving meals." N.C. GEN. STAT. § 18A-30(4) (Interim Supp. 1978); see 4 N.C. AD. CODE 2L § .0201 (1978). Grills, snack bars, lunch counters and fast food outlets are not considered restaurants. *Id.* While a restaurant must, at a minimum, have an inside dining area with a capacity to seat at least 36 persons, *id.*, there are numerous other characteristics that will be considered by the State ABC Board before it issues a permit. These factors include: (1) whether the facility has a printed menu listing full meals with substantial entrees; (2) whether it has full cooking and refrigeration equipment; (3) whether the largest portion of the food sold is prepared in its own kitchen; (4) whether the largest portion of the food sold is consumed on its premises; (5) whether there are separate kitchen and service staffs; (6) whether seating for dining is primarily at tables; and (7) whether only a small portion of the premises is devoted to activities other than dining. *Id.* § .0201(b).

138. A social establishment is a "private facility organized and operated . . . solely for a social, recreational, patriotic or fraternal purpose." *Id.* § .0301.

139. A copy of the regulations, which are quite extensive, can be obtained from the State ABC Board, P.O. Box 25249, Raleigh, N.C. 27611.

140. 4 N.C. AD. CODE 2L §§ .0205-.0206. Hotels include "hotels, motels and similar places which furnish lodging." *Id.* § .0205. "A hotel with a restaurant is a facility open to the general public, engaged primarily and substantially in the business of furnishing lodging and including on its premises a restaurant which has a kitchen and inside seating for at least 36 persons. . . . To qualify for a mixed beverages permit as a hotel with a restaurant, a majority of the gross receipts of the business must come from furnishing lodging." *Id.* In addition, the eligibility of a restaurant within a hotel is dependent on the considerations listed in *id.* § .0201(b), discussed in note 137 *supra*.

141. 4 N.C. AD. CODE 2L § .0201 (1978). The lounge in a restaurant must share a common kitchen and entrance with the dining area, cannot have a separate outside entrance and can remain open only so long as the dining area is open. Although the lounge does not have to serve meals, it must have food available at all times. *Id.*

142. *Id.* § .0205(b). A hotel's restaurant and lounge do not have to be connected if the restaurant's services are available in the lounge. Sales are also allowed in convention rooms, meeting rooms and similar places but only during scheduled events and only after a sign indicating the nature of the event has been posted. No sales, however, are allowed through room service. *Id.*

143. *Id.* § .0302(b). Some of the other requirements are: (1) that the facility collect an annual

Although the regulations are comprehensive,¹⁴⁴ questions remain about administering the liquor by the drink system. Restaurants in a local unit that has approved mixed drinks can no longer have brown-bagging,¹⁴⁵ while social establishments are allowed to have both. Yet seemingly, the rationale behind the bill—that allowing sales of mixed drinks permits greater control over consumption than brown-bagging does—should also apply to social establishments. Legislation has been introduced that would force some social establishments to choose between the two.¹⁴⁶ The most serious question, perhaps, concerns who may hold a mixed drink referendum. The statute allows the local governing board or twenty percent of the voters in cities and counties with ABC stores to call a referendum.¹⁴⁷ In those cities that have passed local laws creating city ABC systems in counties in which there is no county-wide system,¹⁴⁸ only a city-wide vote may be held.¹⁴⁹ If there is a county-wide ABC system and no separate city system, however, the statute is ambiguous about whether any city within the county could call a separate election to vote on mixed drinks.¹⁵⁰

G. Health Care

In 1978, only five years after certificate of need legislation was struck down as unconstitutional by the North Carolina Supreme Court,¹⁵¹ the General Assembly again enacted such legislation¹⁵² as re-

membership fee separate from any cover charge; (2) that it maintain a written policy on the granting of memberships; (3) that it require each prospective member to complete a detailed application; and (4) that it have a membership committee of at least three persons to review all applications and make recommendations to the full membership. *Id.* § .0302. In addition, there are numerous other factors that will be considered in determining whether a facility qualifies as a social establishment. *See id.* § .0301(b).

144. Other important regulations place strict limits on advertising. *See id.* §§ .0501-.0505. For example, restaurants and hotels, but not social establishments, can have a single exterior sign, with specific size limits, stating "mixed beverages" or "all ABC permits" in letters no higher than five inches. These words are the only ones allowed in media advertising. In addition, advertisements of prices and "happy hours" are barred. Interior advertising is restricted to a separate mixed drink menu and the display of bottles to be used in mixing drinks. When a social establishment advertises in any manner, the words "not open to the general public" must be included. *Id.*

145. N.C. GEN. STAT. § 18A-31(e) (Interim Supp. 1978).

146. H. 206, N.C. General Assembly, 1979 Sess.

147. N.C. GEN. STAT. § 18A-51(b).

148. North Carolina law has traditionally provided only for county-wide ABC elections. *See id.* § 18A-51.

149. *See id.* § 18A-51(b).

150. Legislation has also been introduced to allow such cities, under certain circumstances, to hold mixed drink elections. H. 631, N.C. General Assembly, 1979 Sess.

151. *In re Certificate of Need for Aston Park Hosp., Inc.*, 282 N.C. 542, 193 S.E.2d 729 (1973).

152. North Carolina Health Planning and Resource Development Act of 1978, ch. 1182, 1977

quired under the National Health Planning and Resources Development Act of 1974¹⁵³ as a condition to receiving certain federal health care funds.

The new state legislation is designed to restrict the unnecessary capital expenditures in the health care industry that many claim have contributed to the rising costs of health care¹⁵⁴ by requiring a certificate of need to be obtained from a state agency before the development of new health care services and facilities.¹⁵⁵ The statute describes the review process for securing a certificate, assigns reviewing roles to the North Carolina Department of Human Resources and local health planning agencies, and sets forth criteria that the reviewing agency must consider.¹⁵⁶ Violation of the certificate requirements is ground for injunctive relief, loss of licensing and public funding, and civil fines of up to \$20,000.¹⁵⁷

While certificate of need legislation is widely considered a reasonable solution to the problem of spiraling health care costs,¹⁵⁸ it has had problems in North Carolina. In the 1973 case of *In re Certificate of Need for Aston Park Hospital, Inc.*,¹⁵⁹ the North Carolina Supreme Court declared the state's 1971 certificate of need statute to be a deprivation of liberty without due process in violation of the North Carolina

N.C. Sess. Laws, 2d Sess. 1978, at 71 (codified at N.C. GEN. STAT. §§ 131-175 to -188 (Interim Supp. 1978)).

153. 42 U.S.C. §§ 300k-300t (1976). The Act provides for the establishment of agencies and procedures for implementing a national health planning policy. In order to qualify for funds under a variety of federally funded programs, a state must meet the detailed criteria of the Act. *Id.* § 300m(d). One of the criteria is that the state implement a certificate of need program. *Id.* § 300m-2(a)(4)(B).

154. For a discussion of the background and rationale of certificate of need legislation, see Havighurst, *Regulation of Health Facilities and Services by "Certificate of Need,"* 59 VA. L. REV. 1143 (1973). In a typical industry, increased capital expenditures normally result from an increase in consumer demand for the industry's goods and services. Proponents of certificate of need legislation contend that the health care industry, however, is not responsive to these normal market pressures, but that instead physicians, the suppliers of health services, primarily control the demand for new and larger hospital services by determining if hospitalization is necessary, selecting the hospital to be used, and deciding what services are needed during the hospitalization. *Id.* at 1162-63. See also Blumstein & Sloan, *Health Planning and Regulation Through Certificate of Need: An Overview*, 1978 UTAH L. REV. 3, 3-7.

155. In general, a certificate of need is required for any capital expenditure over \$150,000 by or on behalf of a health care facility. N.C. GEN. STAT. § 131-178 (Interim Supp. 1978).

156. The criteria include: (1) an area's need for the services; (2) availability of alternatives; (3) financial feasibility and impact of the proposed services; (4) relationship of the services to the State Health Plan (required by the federal government in order to receive federal health care funds); and (5) availability of supporting resources, including medical personnel. *Id.* § 131-181(a).

157. *Id.* § 131-187.

158. See text accompanying note 168 *infra*.

159. 282 N.C. 542, 193 S.E.2d 729 (1973).

Constitution¹⁶⁰ because it prohibited the building of health care facilities with private funds on the sole basis of a Medical Commission finding of lack of need. Unconvinced that the health care industry was an atypical industry in its response to free market competition and suspicious that the statute was special interest legislation for the benefit of existing hospitals, the court found that there was no rational relationship between certificate of need legislation and the promotion of any public good.¹⁶¹

In light of *Aston Park*, North Carolina in *North Carolina ex rel. Morrow v. Califano*¹⁶² challenged the constitutionality of the federal Health Planning Act's requirement of certificate of need programs as a prerequisite to receiving federal funds, claiming the requirement was an unlawful federal interference with the state because it would compel the state to amend its constitution in order to qualify for federal monies.¹⁶³ The United States Supreme Court affirmed the district court finding that the Act was not coercive but merely put reasonable conditions on obtaining federal aid.¹⁶⁴ Consequently, North Carolina was required to enact new certificate of need legislation or lose millions of federal dollars used to fund over forty state health care programs.¹⁶⁵

The new North Carolina certificate of need legislation which became effective on January 1, 1979, follows generally the regulations promulgated to implement the federal act and is much more comprehensive than the 1971 statute. Nevertheless, its constitutionality is likely to be challenged. Because the state supreme court found certifi-

160. See N.C. CONST. art. I, § 19.

161. 282 N.C. at 549-51, 193 S.E.2d at 734-35. The court held that the statute also violated the provisions of the North Carolina Constitution that forbid exclusive emoluments and monopolies. *Id.* at 551, 193 S.E.2d at 736.

162. 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 98 S. Ct. 1597 (1978). The State sought to enjoin the enforcement of the certificate of need requirement in the Health Planning Act.

163. Acknowledging that the federal government may attach conditions to grants when the conditions are legitimately related to the grants' purposes, North Carolina argued that the power to attach conditions did not extend to coercing a state either to amend its constitution or to give up needed federal aid. *Id.* at 533-35. The point at which conditional federal appropriation grants exceed the Congressional spending power and become weapons by which states can be coerced to act in accordance with the conditions is an issue that has pervaded constitutional law. See, e.g., *Oklahoma v. United States Civil Serv. Comm'n*, 330 U.S. 127 (1947); *Stewart Mach. Co. v. Davis*, 301 U.S. 548 (1937).

164. 98 S. Ct. 1597 (1978). The district court, finding the certificate of need requirement to be a reasonable condition designed to ensure that federal funds not contribute to the inflation of health care costs, reasoned that such conditions could not be defeated by "some oddity" of a state's constitution. 445 F. Supp. at 535. In addition, because North Carolina stood to forfeit less than \$50 million in federal aid compared with state revenues in 1974 of over \$3 billion, the court believed that the degree of coercion was exaggerated. *Id.*

165. 445 F. Supp. at 535.

cate of need legislation itself to be unconstitutional, it is unlikely that it will be able to uphold the new statute without overruling *Aston Park*. There are many factors, however, that may justify overruling that decision. First, while the record in *Aston Park* did not adequately explain the need for singling out the health care industry,¹⁶⁶ an extensive legislative study¹⁶⁷ on the need for a certificate of need law with findings of fact that are incorporated in the statute will make it easier to demonstrate that the statute is a reasonable response to an important social problem. That Congress has encouraged certificate of need legislation, that more than two-thirds of the states have passed such laws,¹⁶⁸ and that the laws have been upheld in every instance in which they have been challenged¹⁶⁹ further emphasizes the rational basis for certificate of need legislation. Finally, because of the complexities of the problem, the new statute is the kind of legislation for which judicial deference to a legislative judgment is appropriate. If the supreme court does not overrule its prior decision, however, then North Carolina will be forced to decide whether to sacrifice approximately \$55 million a year in federal funds or to amend its constitution.

H. Coastal Area Management Act

The North Carolina General Assembly in 1974 passed the Coastal Area Management Act (CAMA),¹⁷⁰ designed to establish a program for the orderly development of North Carolina's coastal area, and for the preservation of its natural resources.¹⁷¹ Under the Act, a Coastal Re-

166. The major arguments presented to justify the certificate of need requirement were (1) that there was a shortage of medical personnel in the area to be served by the proposed facility that would be aggravated by the presence of another hospital and (2) that there were costs to society involved in the construction of unnecessary hospital facilities. Brief for Appellant at 11-12. Similar arguments, however, might apply to other industries.

167. LEGISLATIVE COMMISSION ON MEDICAL COST CONTAINMENT, INTERIM REPORT TO THE GENERAL ASSEMBLY OF NORTH CAROLINA, SECOND SESSION 80 (1978).

168. See Blumstein & Sloan, *supra* note 154, at 3. In addition, more than twenty of these states had done so before the enactment of the federal Health Planning Act. See Havighurst, *supra* note 154, at 1144.

169. The constitutionality of certificate of need legislation has been affirmed in four other cases. *Goodin v. Oklahoma*, 436 F. Supp. 583 (W.D. Okla. 1977); *Simon v. Cameron*, 337 F. Supp. 1380 (C.D. Cal. 1970); *Merry Heart Nursing & Convalescent Home, Inc. v. Dougherty*, 131 N.J. Super. 412, 330 A.2d 370 (1974); *Attoma v. State Dep't of Social Welfare*, 26 A.D.2d 12, 270 N.Y.S.2d 167 (1966).

170. Law of April 1, 1974, ch. 1284, § 1, 1973 N.C. Sess. Laws, 2d Sess. 1974, 463 (codified at N.C. GEN. STAT. § 113A-100 to -128 (1978)).

171. N.C. GEN. STAT. § 113A-102(b) (1978). See generally Schoenbaum, *The Management of Land and Water Use in the Coastal Zone: A New Law is Enacted in North Carolina*, 53 N.C.L. REV. 275, 275-79 (1974).

sources Commission (CRC) was established,¹⁷² among whose duties are the promulgation of guidelines for the development of the coastal zone,¹⁷³ and the designation of certain "areas of environmental concern" (AEC) for special protection.¹⁷⁴ In *Adams v. North Carolina Department of Natural and Economic Resources*,¹⁷⁵ the first court test of the CAMA, the North Carolina Supreme Court found the act to be constitutional. The court held that there had been no unlawful delegation of legislative power to the CRC, and, for the first time, held that the presence of procedural safeguards may be considered in evaluating a delegation of power.

Plaintiffs in *Adams* were several landowners in two coastal counties whose lands had been designated as interim AEC's by the CRC.¹⁷⁶ Among other constitutional challenges,¹⁷⁷ plaintiff alleged that in giving the CRC the authority to promulgate guidelines for the coastal zone, the General Assembly had unlawfully delegated legislative power to an administrative agency.¹⁷⁸ In holding that there had been no unlawful delegation of legislative power,¹⁷⁹ the supreme court for the first time explicitly recognized that one policy underlying the nondelegation doctrine is the prevention of the arbitrary exercise of power by administrative agencies. Thus the presence of procedural safeguards is relevant in evaluating a delegation of legislative power.

The nondelegation doctrine is derived from two provisions of the

172. N.C. GEN. STAT. § 113A-104(a) (1978). The CRC consists of 15 members, at least 12 of whom must be experienced in some activity related to the coastal zone, or in local government in the coastal zone. *Id.* at § 113A-104(b). The members are all appointed by the Governor, from among persons nominated by the boards of commissioners of coastal counties. *Id.* § 113A-104(c).

173. *Id.* § 113A-102(b)(4).

174. *Id.* § 113A-113(a). The statute lists the types of lands that may be designated as AEC's. These include coastal wetlands, estuarine waters, fragile or historic areas, and natural hazard AEC's in land use planning. See Schoenbaum and Silliman, *Coastal Planning: The Designation and Management of Areas of Critical Environmental Concern*, 13 URB. L. ANN. 15 (1977).

175. 295 N.C. 683, 249 S.E.2d 402 (1978).

176. *Id.* at 703, 249 S.E.2d at 414.

177. Plaintiffs also argued that the CAMA was a local act prohibited by N.C. CONST. art. II, § 24. 295 N.C. at 689, 249 S.E.2d at 406. The court rejected this argument, holding that the CAMA was a general law, and noted that a statute that by its terms applies only to a particular part of the state will be considered a general law if the classification is reasonable and based on rational distinctions related to the purposes of the statute. *Id.* at 691, 249 S.E.2d at 407. See this Survey, *Constitutional Law: North Carolina Constitution*.

Furthermore, plaintiffs argued that the CAMA and the guidelines adopted by the CRC deprived them of property without due process of law, and that the CAMA authorized unconstitutional warrantless searches. 295 N.C. at 702, 249 S.E.2d at 413. In each instance, the court held that the complaints were premature, as the plaintiffs had failed to show injury resulting from either of the alleged constitutional defects. *Id.* at 703-05, 249 S.E.2d at 414-15.

178. 295 N.C. at 689, 249 S.E.2d at 406.

179. *Id.* at 698, 249 S.E.2d at 411.

North Carolina Constitution. Article I, section 6 provides: "The legislative, executive, and supreme judicial powers of the State government shall be forever separate and distinct from each other." Article II, section 1 provides: "The legislative power of the State shall be vested in the General Assembly" The court has interpreted these provisions to mean that the General Assembly may not delegate its legislative power to another branch of the government.¹⁸⁰ Nevertheless, it is generally recognized today that a modern government must delegate a certain portion of the legislative power to administrative agencies. As a result, the real issue under the nondelegation doctrine concerns the limits of a valid delegation. In the test that has been applied in North Carolina, as well as in most other states, courts insist that a delegation of power be accompanied by standards adequate to guide the agency in its exercise of power.¹⁸¹

In *Adams*, the court explicitly recognized that the nondelegation doctrine serves both to prevent the abdication by the legislature of its policymaking responsibilities, and to guard against the abuse of discretionary power by administrative agencies.¹⁸² By recognizing the policy of curbing agency discretionary power, the court for the first time made the presence of procedural safeguards a relevant consideration in assessing the validity of a particular delegation.¹⁸³ Thus in addressing the delegation to the CRC of the power to promulgate guidelines, the court discussed both the guiding standards and procedural safeguards supplied by the legislature.

The standards provided to guide the CRC in the promulgation of guidelines for the coastal zone are contained primarily in the CAMA's statement of goals;¹⁸⁴ the court found additional standards in the CAMA's statement of legislative findings,¹⁸⁵ and in the criteria required to be considered by the CRC in the designation of AEC's.¹⁸⁶ The court held these standards to be sufficiently clear to guide the CRC

180. *Id.* at 696, 249 S.E.2d at 410; *State Educ. Assistance Auth. v. Bank of Statesville*, 276 N.C. 576, 589, 174 S.E.2d 551, 561 (1970); *Redev. Comm'n v. Security Nat'l Bank*, 252 N.C. 595, 608, 114 S.E.2d 688, 697-98 (1960).

181. *See, e.g., Carolina-Virginia Coastal Highway v. Coastal Turnpike Auth.*, 237 N.C. 52, 74 S.E.2d 310 (1953). *See generally* 1 F. COOPER, *STATE ADMINISTRATIVE LAW* 54-70 (1965).

182. 295 N.C. at 697-98, 249 S.E.2d at 411.

183. *Id.* at 698, 249 S.E.2d at 411.

184. The guidelines promulgated by the CRC must be consistent with the goals of the CAMA. N.C. GEN. STAT. § 113A-107(a) (1978). The goals of the Act are set forth at *id.* § 113A-102(b).

185. 295 N.C. at 700, 249 S.E.2d at 412. These findings are set forth at N.C. GEN. STAT. § 113A-102(a) (1978).

186. 295 N.C. at 700, 249 S.E.2d at 412. These criteria are set forth at N.C. GEN. STAT. § 113A-113(b) (1978).

in the promulgation of guidelines. The court noted that the standards were "as specific as circumstances permit,"¹⁸⁷ and that the promulgation of guidelines would require considerable expertise, which the CRC would possess.¹⁸⁸

The court then discussed the procedural framework within which the CRC must operate. The court found four different procedural safeguards for the promulgation of guidelines by the CRC:¹⁸⁹ those contained within the CAMA;¹⁹⁰ those in North Carolina's Administrative Procedures Act (APA);¹⁹¹ those provided by the Administrative Rules Committee of the General Assembly;¹⁹² and those in North Carolina's "sunset" legislation.¹⁹³ The court then held that since there were sufficiently specific guiding standards and adequate procedural safeguards, the delegation of power to the CRC was constitutional.¹⁹⁴

The court presented little argument or explanation for the incorporation of a procedural safeguards criterion into the nondelegation doctrine. It stated only that a key purpose of the guiding standards test is to prevent arbitrary action by an administrative agency,¹⁹⁵ and the procedural safeguards tend to "encourage adherence to legislative standards."¹⁹⁶ The court then stated that it was joining the "growing trend of authority," citing Professor Davis' *Administrative Law Treatise*.¹⁹⁷ The court was apparently referring to decisions cited by Professor Davis holding that procedural safeguards should be considered in evaluating a delegation of power. These courts generally have recognized as

187. 295 N.C. at 700, 249 S.E.2d at 412 (quoting *North Carolina Turnpike Auth. v. Pine Island, Inc.*, 265 N.C. 109, 115, 143 S.E.2d 319, 323 (1965)).

188. 295 N.C. at 700-01, 249 S.E.2d at 412.

189. *Id.* at 701, 249 S.E.2d at 412.

190. *Id.* at 701, 249 S.E.2d at 413. These procedures are set forth at N.C. GEN. STAT. § 113A-107 (1978).

191. 295 N.C. at 702, 249 S.E.2d at 413. The court stated that amendments to the guidelines would be subject to the requirements of the Administrative Procedures Act, N.C. GEN. STAT. § 150A-1 to -64 (1978).

192. 295 N.C. at 702, 249 S.E.2d at 413. The Administrative Rules Review Committee is a committee of the Legislative Research Commission, N.C. GEN. STAT. § 120-30.26 (Supp. 1977), which reviews agency rules to "determine whether or not the agency acted within its statutory authority in promulgating the rule," *id.* § 120-30.28(a).

193. 295 N.C. at 702, 249 S.E.2d at 413. Under the "sunset" legislation, N.C. GEN. STAT. § 143-34.10 to .21 (1978), the CAMA will be repealed as of July 1981. *Id.* § 143-34.12. Prior to its termination, the CAMA will be reviewed by the Governmental Evaluation Committee, which will recommend to the General Assembly that the Act be continued, modified, or terminated. *Id.* § 143-34.16.

194. 295 N.C. at 702, 249 S.E.2d at 413.

195. *Id.* at 698, 249 S.E.2d at 411.

196. *Id.*

197. *Id.* (citing 1 K. DAVIS, *ADMINISTRATIVE LAW TREATISE* 210 (2d. ed. 1978)).

underlying the nondelegation doctrine the same policies noted by the court in *Adams*.¹⁹⁸

While the court did not cite any North Carolina authority, the adoption of a procedural safeguards criterion is consistent with North Carolina case law. Although the court has never before explicitly acknowledged that a purpose of the nondelegation doctrine is to prevent arbitrary administrative action, that had been a significant factor in some cases.¹⁹⁹ With this explicitly stated policy behind the doctrine, any factors that may limit the ability of administrative agencies to act in an arbitrary manner become relevant. Procedural safeguards are probably the most effective restriction on the discretionary power of administrative agencies.²⁰⁰

The court's decision in *Adams* should provide some guidance to the legislature in the drafting of future statutes. If the legislature believes that a broad delegation of power to an administrative agency is appropriate in a given situation, that delegation should be accompanied by procedural safeguards. It seems clear after *Adams* that such a delegation is more likely to survive a constitutional attack if so drawn. This position is appropriate, since there is a greater potential for arbitrary action by an administrative agency when the delegation is broad,

198. See, e.g., *William Penn Parking Garage, Inc. v. City of Pittsburgh*, 464 Pa. 168, 213, 346 A.2d 269, 291 (1975); *Jennings v. Exeter-West Greenwich Regional School Dist. Comm.*, 116 R.I. 90, 98-99, 352 A.2d 634, 638-39 (1976).

199. See, e.g., *Carolina-Virginia Coastal Highway v. Coastal Turnpike Auth.*, 237 N.C. 52, 74 S.E.2d 310 (1953). The court held invalid a delegation of power to the Municipal Board of Control. The General Assembly had authorized this agency to organize a municipal corporation to construct a toll road if it determined the road to be "in the public interest." *Id.* at 56, 74 S.E.2d at 313. The court held that "the power to determine whether the construction . . . of a toll road . . . will be 'in the public interest' is purely a legislative question to be resolved only in the exercise or under the direction of legislative powers of guidance and control." *Id.* at 63, 74 S.E.2d at 315. The court also noted that the statute attempted to "clothe the members of this administrative agency with apparent power in their unguided discretion to give or withhold the benefits of the law in any given case or cases." *Id.*

For other cases in which the court has apparently been concerned about the abuse of discretionary power by administrative agencies, see *State v. Williams*, 253 N.C. 337, 117 S.E.2d 444 (1960)(statute requiring that persons soliciting students for schools be licensed because issuance of license in given situation depended on "unlimited discretion of the administrative body" held invalid) and *Harvell v. Scheidt*, 249 N.C. 699, 107 S.E.2d 549 (1959)(delegation to Commissioner of Motor Vehicles of power to revoke license of any person who was a "habitual violator of the traffic laws" held unlawful). Other factors appear to have influenced the court in various cases. It has been suggested that the court will permit a broader delegation of authority when the delegation is to a body with expertise in the subject matter of the delegation. Glenn, *The Coastal Area Management Act in the Courts: A Preliminary Analysis*, 53 N.C.L. REV. 303, 319 (1974). In addition, it seems fairly clear that the court will not insist on more detailed standards than is practicable. In *North Carolina Turnpike Auth. v. Pine Island, Inc.*, 265 N.C. 109, 143 S.E.2d 319 (1965), the court approved a delegation of power for which the legislature had provided standards that were "as specific as the circumstances permit."

200. See 1 K. DAVIS, *ADMINISTRATIVE LAW TREATISE* 214-15 (2d ed. 1978).

and the need for safeguards is greater.²⁰¹

It is also possible, as a result of the decision in *Adams*, that it will be more difficult for a constitutional attack based on the delegation doctrine to succeed. Two of the procedural safeguards the court found significant, the APA and the Administrative Rules Review Committee, are presumably of general applicability. The "sunset" legislation also may be applicable if new statutes are brought under it. These will provide some procedural safeguards and some legislative oversight of any new delegation of power, in addition to whatever standards and safeguards might accompany the delegation. These factors certainly would not preclude a successful constitutional attack, but may make one less likely.

I. Professional Responsibility and Administration of Justice

In *Aetna Casualty & Surety Co. v. United States*,²⁰² a suit arising out of a 1974 Eastern Airlines plane crash in Charlotte, the United States Court of Appeals for the Fourth Circuit considered the question of when an attorney may represent multiple defendants without violating the Code of Professional Responsibility of the North Carolina State Bar. Plaintiffs, having paid claims based on the crash, brought suit in federal district court²⁰³ as subrogees against the United States under the Federal Tort Claims Act and against four air traffic controllers, employees of the Federal Aviation Administration, claiming that defendants negligently caused the crash. All defendants were represented by counsel provided by the United States Department of Justice and by the United States attorney. On plaintiffs' motion, the district judge disqualified government counsel from representing the air traffic controllers. The court found an irreconcilable conflict of interest in the multiple representation in violation of Disciplinary Rule 5-105(B),²⁰⁴

201. See *City of Amsterdam v. Helsby*, 37 N.Y.2d 19, 332 N.E.2d 290, 299 371 N.Y.S.2d 404 (1975).

202. 570 F.2d 1197 (4th Cir. 1978).

203. 438 F. Supp. 886 (W.D.N.C. 1977), *rev'd*, 570 F.2d 1197 (4th Cir. 1978).

204. NORTH CAROLINA CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105(B) provides: "A lawyer shall not continue multiple employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by his representation of another client, except to the extent permitted under DR 5-105(C)." DR 5-105(C) permits multiple representation "if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each." *Id.* EC 5-15 provides, in pertinent part: "A lawyer should never represent in litigation multiple clients with conflicting interests and there are few situations in which he would be justified in representing in litigation multiple clients with potentially conflicting interests."

which prohibits multiple representation when the attorney's independent professional judgment in behalf of one client will or is likely to be impaired by his representation of another client. The court of appeals reversed, however, finding that defendant's attorneys had met the dual requirements of DR 5-105(C), which allows an attorney to represent multiple clients "if it is obvious that he can adequately represent the interest of each and if each consents to the representation after full disclosure of the possible effect of such representation on the exercise of his independent professional judgment on behalf of each."²⁰⁵

The significance of *Aetna* lies not in the courts' disagreement over the applicability of DR 5-105(C),²⁰⁶ but in the scope of review used by the court of appeals and in the court's consideration of factors not expressly mentioned in the disciplinary rules. The court declined to limit the scope of its review to determining whether the district court had abused its discretion. Following the lead of the United States Court of Appeals for the Fifth Circuit, it asserted that it would inquire, "in [a case] where the facts are not in dispute, . . . whether the District Court's disqualification order was predicated upon a proper understanding of applicable ethical principles."²⁰⁷ This scope of review would give little deference to the district court opinion.

In its inquiry under this broad scope of review, the court consid-

205. *Id.* DR 5-105(C).

206. The district court declined to presume that a client's consent could be fully informed when procured without the advice of a lawyer with no conflict of interest. 438 F. Supp. 886, 888 (W.D.N.C. 1977). The court held that the second requirement of DR 5-105(C), that the attorney have an "obvious" ability to represent adequately each defendant's interest, was not met because of the possibility that each defendant might wish to avoid liability by suggesting that one or more of his codefendants was responsible, to the exclusion of himself. *Id.* at 887-88. The district court was also concerned about the possible liability of individual defendants for damages, should they be found negligent. *Id.* at 889. Regarding the other defendant, the government, the district court expressed concern about the right of taxpayers to be represented by a district attorney or attorney general whose loyalty is not clouded by possible conflicting claims or rights of the controllers themselves. *Id.* at 888.

The court of appeals found no authority to support the district court's theory regarding informed consent. It noted that, in any event, counsel for the air controllers' union had participated in discussions between the individual defendants and the Department of Justice; the court thought it "reasonable to assume that he was aware of any problems and properly advised the controllers with respect to their best interests." 570 F.2d at 1202. In rejecting as conjecture the district court's concern about possible conflicts of interest among the codefendants, the court stressed the assurance by Government counsel that there was no dispute among defendants with respect to the duties of the controllers or the details of the plane crash. *Id.* at 1201. Concerning the individual liability of defendants, the court concluded there was "little or no possibility . . . of personal liability." *Id.* The issue of scope of employment was conceded, so a finding of negligence against the air controllers would be imputed to the Government. A finding of joint liability would bar the entry of any contemporaneous or subsequent judgment against the air controllers. *Id.*

207. 570 F.2d at 1200 (quoting *Woods v. Covington County Bank*, 537 F.2d 804, 810 (5th Cir. 1976)).

ered several factors in addition to the considerations set out in the disciplinary rules. First, the court noted the advantage to the air traffic controllers of representation by Government counsel with access to "the reservoir of the Government's expertise."²⁰⁸ Also of considerable concern to the court was the increasing number of motions to disqualify upon "alleged ethical grounds."²⁰⁹ The court suspected that in moving to disqualify, plaintiff was motivated "more by [an apparent] desire to fragmentize the defense than by any sensitivity to the ethical considerations involved."²¹⁰

This approach to disqualification on ethical grounds has also been taken by the Court of Appeals for the Second Circuit, which rejected "a mechanical and didactic application of the [Disciplinary] Code to all situations,"²¹¹ and by the Court of Appeals for the Fifth Circuit, which stated: "A court should be conscious of its responsibility to preserve a reasonable balance between the need to ensure ethical conduct on the part of lawyers . . . and other social interests, which include the litigant's right to freely chosen counsel."²¹² By considering factors in addition to those explicitly the concern of the Code, rigid application of the disciplinary rules leading to an excessive number of disqualifications can be avoided. The adoption by the Court of Appeals for the Fourth Circuit of a similarly broad approach should lead to an increasing number of denials of motions to disqualify.

208. *Id.* at 1202. The court referred also to the "burden upon [the air traffic controllers'] time and resources incident to the employment of independent counsel." *Id.* Whether there would also be a financial burden is not clear. The district court quoted from a Justice Department policy statement, which stated the Department's intent to "[p]lay for representation by a private attorney when several employees, otherwise entitled to representation by the Department, have sufficiently conflicting interests which in the Department's view preclude representation of each of them by the Department." 438 F. Supp. 886, 890 (W.D.N.C. 1977)(quoting United States Department of Justice, STATEMENTS OF POLICY: Order No. 683-77 (Jan. 19, 1977)).

209. 570 F.2d at 1202; *cf.* *Woods v. Covington County Bank*, 537 F.2d 804, 819 (5th Cir. 1976) ("Inasmuch as attempts to disqualify opposing counsel are becoming increasingly frequent, we cannot permit Canon 9 (prohibiting conduct which gives the appearance of impropriety) to be manipulated for strategic advantage on the account of an impropriety which exists only in the minds of imaginative lawyers.").

210. 570 F.2d at 1201 n.7. The court also distinguished Canon 4 (preserving confidences and secrets of a client), which protects the rights of both adversaries in the litigation and provides firmer ground for a motion to disqualify opposing counsel, from Canon 5 (exercise of independent professional judgment on behalf of client), which is addressed solely to the relationship between the attorney and his immediate clients. *Id.*

211. *International Elecs. Corp. v. Flanzer*, 527 F.2d 1288, 1293 (2d Cir. 1975) (quoting *Amicus Curiae Brief of the Connecticut Bar Association*).

212. *Woods v. Covington County Bank*, 537 F.2d 804, 810 (5th Cir. 1976). The district court in *Aetna* had asserted that the ethical principles involved should be considered without regard to other factors, such as the cost to taxpayers or individuals of private counsel for individual defendants. 438 F. Supp. 886, 889 (W.D.N.C. 1977).

The North Carolina Court of Appeals considered *Aetna's* implications in *Swenson v. Thibaut*,²¹³ a shareholders' derivative suit in which defendant moved to disqualify plaintiff's attorney on the basis of alleged violations of canons two, four, five and nine.²¹⁴ The trial judge denied these motions. On appeal, defendant, citing *Aetna*, urged the court of appeals to look beyond a possible abuse of discretion, and consider whether the trial judge had correctly applied ethical principles to the evidence before him.²¹⁵ The court of appeals interpreted this suggestion as "placing this Court in the position of functionally sitting as a court of original jurisdiction to consider these ethical questions without reference or deference to the proceedings below."²¹⁶ The court expressed reluctance to follow what it perceived to be the *Aetna* approach, indicating that it would not ignore or give only minimal deference to the trial judge's findings and conclusions in reference to the ethical questions.²¹⁷ In affirming the trial judge's decisions, however, the court sounded as if it were applying the *Aetna* scope of review: "The rulings of the trial judge, upon the evidence before him, are in complete agreement with the conclusions we reach upon the same evidence"²¹⁸ This language suggests that the court of appeals will not defer in cases in which it reaches different conclusions from those of the trial judge.

The *Swenson* court was more clearly in agreement with the *Aetna* court regarding the consideration on a motion to disqualify of practical factors in addition to the conflict of interest concerns of the disciplinary rules. It asserted that "the court's inherent power is not limited or bound by the technical precepts contained in the Code of Professional Responsibility as administered by the Bar."²¹⁹

While the question whether a strict or flexible approach to motions to disqualify will be followed in North Carolina seems settled at the court of appeals level by *Swenson*, the question of the scope of judicial review may have to await a case in which the court of appeals disagrees

213. 39 N.C. App. 77, 250 S.E.2d 279 (1978).

214. NORTH CAROLINA CODE OF PROFESSIONAL RESPONSIBILITY, Canon 2 (improper solicitation); *id.* Canon 4 (breach of the confidential attorney-client relationship); *id.* Canon 5 (improper interest in the subject matter of the litigation); *id.* Canon 9 (appearance of professional impropriety).

215. 39 N.C. App. at 108, 250 S.E.2d at 299.

216. *Id.*

217. *Id.* at 109, 250 S.E.2d at 299.

218. *Id.* at 114, 250 S.E.2d at 302.

219. *Id.* at 109, 250 S.E.2d at 299.

with a trial court decision on a motion to disqualify, and must clarify its holding in *Swenson*.

Several 1978 North Carolina cases concerned the power of the courts to discipline attorneys. In *In re Palmer*,²²⁰ a superior court hearing had resulted in a dismissal of a disbarment proceeding against attorney Palmer. The attorney general petitioned the court of appeals for a writ of certiorari to review the dismissal, and the writ was granted. The court of appeals subsequently found the grant of the writ to have been improvident on the ground that since G.S. 84-28(h)²²¹ precludes appeal by the State, to grant review on petition for certiorari would be "to allow by indirect means that which is forbidden by direct means."²²² The supreme court reversed, holding that by virtue of the appellate courts' supervisory powers, the State could seek review by writ of certiorari of judicial disciplinary proceedings.²²³

Orders suspending the licenses of attorneys for failure to perfect appeals were vacated in *In re Robinson*²²⁴ and *In re Dale*.²²⁵ In both cases the court of appeals found that the superior court judge may have prejudged the attorneys' conduct before hearing any evidence.²²⁶ Rather than dismissing the charges or remanding for a new hearing, however, the court decided to hold the rehearings itself, in the exercise of its inherent power to discipline attorneys.²²⁷ On rehearing both

220. 37 N.C. App. 220, 245 S.E.2d 791 (1978), *rev'd*, 296 N.C. 638, 252 S.E.2d 784 (1979).

221. N.C. GEN. STAT. § 84-28(h) (Cum. Supp. 1977) provides for an appeal of right for attorneys from an adverse decision, but excludes any mention of the State. Law of April 3, 1933, ch. 210, § 11, 1933 N.C. Pub. Laws 313 (formerly codified as amended at N.C. GEN. STAT. 84-28(3)(f) (1975))(amended 1975), provided a right of appeal for both parties in a disciplinary proceeding against an attorney.

222. 37 N.C. App. at 222, 245 S.E.2d at 793.

223. 296 N.C. 638, 646, 252 S.E.2d 784, 789 (1979).

224. 37 N.C. App. 671, 247 S.E.2d 241 (1978).

225. 37 N.C. App. 680, 247 S.E.2d 246 (1978).

In an address by Harold A. Coley, Jr., counsel to the North Carolina State Bar, to a class in professional responsibility at the University of North Carolina School of Law (January 25, 1979), Mr. Coley stated that the largest category of complaints received by his office against practicing attorneys concerns failure to appear in court and failure to perfect appeals.

226. In his Specifications of Charges No. 1, Judge Snapp used the words "negligently and willfully" in characterizing the alleged conduct of attorney Robinson, 37 N.C. App. at 678, 247 S.E.2d at 245, and the word "negligently" in the specification regarding attorney Dale, 37 N.C. App. at 681, 247 S.E.2d at 247. Speculating that Judge Snapp's "unfortunate and inappropriate choice of words came from the idea of necessity for specific allegations in a third party complaint, rather than from bias or prejudice," 37 N.C. App. at 684, 247 S.E.2d at 249, the court nevertheless concluded in both cases that it could not allow the orders to stand. 37 N.C. App. at 678, 247 S.E.2d at 246; 37 N.C. App. at 684, 247 S.E.2d at 249.

227. 37 N.C. App. at 679, 247 S.E.2d at 246; 37 N.C. App. at 685, 247 S.E.2d at 249. Judge Britt, concurring in the *Dale* result, questioned the power of the court to suspend or disbar an attorney. *Id.* at 686, 247 S.E.2d at 250 (concurring opinion).

Robinson and Dale were suspended from the practice of law.²²⁸

In *In re Hardy*,²²⁹ the North Carolina Supreme Court stated in dictum that it had the power to go beyond a Judicial Standards Commission (JSC) recommendation and order removal of a judge for whom the JSC had recommended censure. In *Hardy*, however, the court declined to exercise its newly stated power and followed the JSC recommendation of censure.²³⁰ The court based its assertion of power upon its construction of the Judicial Standards Commission Act, which provides in pertinent part: "The Supreme Court may approve the recommendation [of the JSC], remand for further proceedings, or reject the recommendation."²³¹ Construing the Judicial Standards Commission Act in light of the presumed legislative intent, the court read the options in the statute as permissive, authorizing the court, unfettered in its adjudication by the recommendation of the JSC, not only to reject the recommendation but to make whatever final judgment it deemed proper.²³²

The majority's broad interpretation of the statute was answered with a strong dissent by Justice Lake.²³³ Justice Lake deemed the majority's interpretation "a distortion of the plain language of the statute"²³⁴ and disagreed with the court's characterization of the JSC as "[a]n arm of this Court,"²³⁵ describing it instead as an independent

228. *In re Dale*, 39 N.C. App. 370, 372, 250 S.E.2d 82 (1979); *In re Robinson*, 39 N.C. App. 345, 349, 250 S.E.2d 79, 82 (1979). Both attorneys were found to have violated NORTH CAROLINA CODE OF PROFESSIONAL RESPONSIBILITY DR 6-101(A), which prohibits lawyers from handling legal matters that they are not competent to handle, or handling legal matters without adequate preparation, or neglecting legal matters entrusted to them. Dale was suspended for 90 days and Robinson for 12 months from practice before the Courts of the Appellate Division and for 6 months from practice in criminal cases.

229. 294 N.C. 90, 240 S.E.2d 367 (1978).

230. Judge Hardy was found to have entered and altered traffic court judgments without the knowledge or consent of the prosecuting attorney. The court found this case to be similar to three earlier judicial misconduct cases, and concluded that fairness required a similar result. *Id.* at 98, 240 S.E.2d at 273.

231. N.C. GEN. STAT. § 7A-377(a) (Cum. Supp. 1977).

232. 294 N.C. at 97, 240 S.E.2d at 372. The court cited, in support of its holding, decisions from other jurisdictions that have considered the question: *In re Robson*, 500 P.2d 657 (Alas. 1972); *Spruance v. Commission on Judicial Qualifications*, 13 Cal. 3d 778, 532 P.2d 1209, 119 Cal. Rptr. 841 (1975); *Geiler v. Commission on Judicial Qualifications*, 10 Cal. 3d 270, 515 P.2d 1, 110 Cal. Rptr. 201 (1973); *In re Kelly*, 238 So. 2d 565 (Fla. 1970); *In re Diener*, 268 Md. 659, 304 A.2d 587 (1973), *cert. denied*, 415 U.S. 989 (1974).

233. 249 N.C. at 98, 240 S.E.2d at 373 (dissenting opinion). Justices Branch and Moore joined the dissent. Justice Lake had dissented from earlier judicial discipline cases, questioning the constitutionality of the statutes creating the JSC. *In re Nowell*, 293 N.C. 235, 252, 237 S.E.2d 246, 237 (1977) (dissenting opinion); *In re Crutchfield*, 289 N.C. 597, 605, 223 S.E.2d 822, 827 (1975) (dissenting opinion).

234. 294 N.C. at 103, 240 S.E.2d at 376 (dissenting opinion).

235. *Id.* at 104, 240 S.E.2d at 376 (quoting majority opinion, *id.* at 97, 240 S.E.2d at 372).

body created by the legislature.²³⁶ According to his dissent the only function of the supreme court in the procedure is to act as a check and restraint upon the JSC.²³⁷ Under the majority's view, Justice Lake observed, four supreme court judges could remove from office a judge whom the JSC and the other three supreme court judges thought deserved no more than censure.²³⁸

In re Martin,²³⁹ the next judicial misconduct case considered by the court, presented the court with a challenge to its jurisdiction over the censure and removal of judges. In 1971, a constitutional amend-

236. *Id.*, 240 S.E.2d at 376.

237. *Id.* Responding to the majority's statement that other jurisdictions support its conclusion, the dissent maintained that such decisions are less helpful in interpreting statutes than in resolving questions of common law. *Id.* at 100, 240 S.E.2d at 374. When the statutory or constitutional language is almost identical in the two jurisdictions, however, a decision from the foreign jurisdiction interpreting that language can be helpful. An Alaska constitutional amendment provides that "a justice or judge may be disqualified from acting as such and may be suspended, removed from office, retired, or censured by the supreme court upon recommendation of the [Commission on Judicial Qualifications]." ALASKA CONST. art. IV, § 10. This language closely parallels the language of N.C. GEN. STAT. § 7A-376 (Cum Supp. 1977). The Alaska court, in deciding to publicly censure a judge whom the Commission had recommended be privately reprimanded, considered that it would be "tantamount to an abdication of our constitutional and statutory obligations if we were to automatically adopt the commission's sanction recommendations." *In re Robson*, 500 P.2d 657, 660 (Alas. 1972).

The Maryland Supreme Court decided, four to three, to remove from office a judge whom the Commission on Judicial Disabilities had recommended be censured. *In re Diener*, 268 Md. 659, 304 A.2d 587 (1973), *cert. denied*, 415 U.S. 989 (1974). The Maryland constitutional amendment that established the procedure provides: "Upon any recommendation of the Commission, the Court of Appeals, after a hearing and upon a finding of misconduct . . . may remove the judge from office or may censure [him] . . ." CONSTITUTION OF MARYLAND, art. IV, § 4B(b). Although this grant of authority, mandating a second hearing by the court of appeals, seems even broader than the grants to the Alaska and North Carolina courts, a strong dissent viewed a recommendation for removal as a condition precedent to an order of removal by the court. 268 Md. at 697, 304 A.2d at 607 (Smith, J., dissenting).

238. 294 N.C. at 100, 240 S.E.2d at 374 (Lake, J., dissenting).

239. 295 N.C. 291, 245 S.E.2d 766 (1978). The *Martin* court, unlike the court in *Hardy*, did substitute its judgment for that of the JSC. As the court decided to censure a judge whom the JSC had recommended be removed, however, the effect of the court's possibly exceeding its power was not as profound as it would be were the court to reject censure in favor of removal.

The court adopted the findings of the JSC regarding several charges of ex parte disposition of cases by the judge. *Id.* at 305-06, 245 S.E.2d at 773-74. Characterizing the judge's conduct in these matters as strikingly similar to, but no more indiscreet than, the judicial misconduct that resulted in censure in previous cases, the court cited its conclusion in *Hardy* that "fairness requires a similar result here." *Id.* at 306, 245 S.E.2d at 775 (quoting *In re Hardy*, 294 N.C. at 98, 240 S.E.2d at 373). Concerning the most serious charge, which amounted to suborning perjury, the court rejected the JSC's findings as unsupported by clear and convincing evidence. *Id.* at 307, 245 S.E.2d at 775. The JSC found as a fact that Judge Martin had requested a police officer to testify under oath that he was not present when a breathalyzer test was administered, although Judge Martin knew the officer was present. *Id.* at 295, 245 S.E.2d at 769. The court found the evidence on this charge to be in sharp conflict. An attorney for the charged party, who was present during the encounter between Judge Martin and the police officer, gave testimony before the JSC tending to show that Judge Martin merely meant to inform the officer that he could not, as an arresting officer, testify to breathalyzer results. *Id.* at 307-08, 245 S.E.2d at 776.

ment was proposed that mandated the creation of a new procedure for judicial discipline,²⁴⁰ but did not expressly provide for jurisdiction in the supreme court. Seventeen months before the ratification of the constitutional amendment, the Judicial Standards Commission Act was passed, which does provide for enforcement of judicial discipline by the supreme court. Appellant in *Martin* challenged the jurisdiction of the court on the ground that because the legislature is not authorized by the North Carolina Constitution²⁴¹ to confer appellate jurisdiction on the supreme court, but rather jurisdiction is conferred directly by the constitution, there was no constitutional basis for the jurisdiction. The court nevertheless claimed jurisdiction based upon the "clear implication"²⁴² of the new amendment, and upon the Judicial Standards Commission Act.²⁴³ The court asserted that ratification of the amendment with knowledge of the passage of the Act carried with it an expression of the will of the people that the jurisdiction be conferred.²⁴⁴

240. N.C. CONST. art. IV, § 17(2) provides in pertinent part: "The General Assembly shall prescribe a procedure, in addition to impeachment and address set forth in this section, for the removal of a Justice or Judge"

241. *Id.* § 12(1) provides that "[t]he supreme court shall have jurisdiction to review upon appeal any decision of the courts below" See also Note, *Judicial Discipline—The North Carolina Commission System*, 54 N.C.L. REV. 1074 (1976).

242. 295 N.C. at 299, 245 S.E.2d at 771.

243. N.C. GEN. STAT. § 7A-376 (Cum. Supp. 1977) provides in pertinent part: "Upon recommendation of the Commission, the Supreme Court may censure or remove any justice or judge for wilful misconduct in office"

244. 295 N.C. at 300, 245 S.E.2d at 771. "The effective date of the Act, however, was made contingent upon the ratification of the amendment" *Id.*; see Law of June 14, 1971, ch. 560, § 3, 1971 N.C. Sess. Laws 488.

The court buttressed its conclusion with the observation that "it seems both appropriate and in accordance with the constitutional plan that the Supreme Court, to which the Constitution gives 'general supervision and control over the proceedings of the other courts' should also have final jurisdiction over the censure and removal of judges and justices." 295 N.C. at 299-300, 245 S.E.2d at 771 (quoting N.C. CONST. art. IV, § 12(1)).

The court's position does not adequately answer the argument that jurisdiction has not been conferred by the constitution and cannot be conferred by statute. It has been suggested that the court may have implicitly determined that the 1972 amendment "overrode" the jurisdiction limitation of article IV, § 12(1), which grants the supreme court jurisdiction to hear only decisions of courts. N.C. CONST. art. IV, § 12(1), quoted in note 241 *supra*; see Note, *Judicial Discipline—The Power of the North Carolina Supreme Court to Remove State Judges—In re Hardy*, 14 WAKE FOREST L. REV. 1187, 1203 n.105 (1978). As the 1972 amendment does not explicitly confer jurisdiction, however, this argument depends upon the court's "will of the people" premise. It is arguable that the voters in ratifying the amendment were not thinking of the contingent enactment of the Judicial Standards Commission Act assigning jurisdiction to the supreme court, but were merely favoring the creation of a new procedure for judicial discipline. Had the amendment explicitly conferred jurisdiction on the court, the will of the people would have been clearly expressed.

J. Insurance

1. Ratemaking

In two cases involving the ratemaking powers of the Commissioner of Insurance, the supreme court and the court of appeals reaffirmed the necessity for administrative agencies to follow statutory requirements regarding ratemaking. *State ex rel. Commissioner of Insurance v. North Carolina Automobile Rate Administrative Office*²⁴⁵ involved motorcycle insurance rates set by the Commissioner pursuant to the enactment in 1975 of G.S. 58-30.3, .4,²⁴⁶ a new classification system for motor vehicle insurance that prohibits classifications of drivers on the basis of age or sex. The Commissioner set two rates for motorcycle insurance based solely on the size of the engine.²⁴⁷ These rates were challenged by the Automobile Rate Administrative Office, which claimed that under the new statute motorcycles were intended to be classified according to primary use and subclassified according to the driving experience of the insured, in the same manner as automobiles.²⁴⁸

The Commissioner defended the new rates on the ground that the legislature had in its 1975 enactment implicitly removed motorcycles from the general classification system of G.S. 58-30.4.²⁴⁹ This argument was rejected by the court,²⁵⁰ which noted that any doubt that may have existed about the legislature's intent in 1975 had been removed by the enactment in 1977 of an amendment to Chapter 58 of the General Statutes²⁵¹ that makes clear that motorcycles are to be classified and subclassified in the same manner as automobiles for insurance ratemaking purposes.²⁵² The court took note of the evidence presented

245. 294 N.C. 60, 241 S.E.2d 324 (1978).

246. Law of June 18, 1975, ch. 666, § 1, 1975 N.C. Sess. Laws 808 (codified as amended at N.C. GEN. STAT. § 58-30.3, .4 (Cum. Supp. 1977)).

247. Before the enactment of § 58-30.3, .4, the Commissioner had attempted to set new motorcycle insurance rates in which all classification and subclassification plans were abolished. The court of appeals found this conduct to be in excess of his statutory authority. *State ex rel. Comm'r of Ins. v. North Carolina Auto. Rate Administrative Office*, 24 N.C. App. 223, 210 S.E.2d 441 (1974), *cert. denied*, 286 N.C. 412, 211 S.E.2d 801 (1975).

248. 294 N.C. at 63, 241 S.E.2d at 326.

249. The Commissioner's claim was based on his assertion that when H. 28, N.C. Gen. Assembly, 1977 Sess., was initially introduced the word "motorcycles" appeared in that portion of the bill that later was codified as § 58-30.4. When the bill ultimately was enacted, however, the word "motorcycles" was deleted from that portion of the bill. See 294 N.C. at 64-65, 241 S.E.2d at 327.

250. See 294 N.C. at 67, 241 S.E.2d at 329.

251. Law of June 30, 1977, ch. 828, § 2, 1977 N.C. Sess. Laws 1119 (codified in scattered sections of N.C. GEN. STAT. § 58-131.35 (Cum. Supp. 1977)).

252. N.C. GEN. STAT. § 58-131.35 (Cum. Supp. 1977) included motorcycles in its definition of

by the Commissioner that premiums for motorcycle liability insurance are higher than they should be, and invited him to institute proper proceedings to reduce the rates, admonishing him that this could not be done by "unlawfully abolishing classifications and subclassifications which are required by statute."²⁵³

The issue of the date of effectiveness of revised automobile medical payments insurance rates was addressed by the court of appeals in *North Carolina Automobile Rate Administrative Office v. Ingram*.²⁵⁴ In 1971, the Rate Office had filed with former Commissioner Lanier a proposed rate reduction in medical insurance premium rates.²⁵⁵ No action was taken on the proposal until 1974, when Commissioner Ingram approved the reduction. He attempted, however, to put the rate change into effect immediately,²⁵⁶ rather than sixty days after the change was announced, as is the standard practice.²⁵⁷ The court of appeals sustained the Rate Office's challenge of the Commissioner's conduct, finding the Commissioner to be statutorily precluded from changing the sixty-day rule that had been adopted by the Governing Committee of the Rate Office without first giving notice, conducting a hearing, and taking evidence.²⁵⁸ As the proper rulemaking procedures had not been

private passenger motor vehicles. N.C. GEN. STAT. § 58-30.4 lists the classifications (including primary use classifications) and subclassifications (including safe driver subclassifications) that are to be observed regarding coverage of private passenger motor vehicles. This portion of § 58-30.4 was not affected by the 1977 amendments.

Before passage of either of the legislative amendments discussed here, the court of appeals had held that "automobile" liability insurance includes "motorcycle" liability insurance and that the same laws apply to both. *State ex rel. Comm'r of Ins. v. North Carolina Auto. Rate Administrative Office*, 24 N.C. App. 223, 226, 210 S.E.2d 441, 443 (1974), *cert denied*, 286 N.C. 412, 211 S.E.2d 801 (1975).

253. 294 N.C. at 72, 241 S.E.2d at 332.

254. 35 N.C. App. 578, 242 S.E.2d 205 (1978).

255. Because of the similarity in the type of hazard, medical payments insurance premium rates are determined by reference to bodily injury insurance rates. Although the Rate Office had filed with the Commissioner's office proposed revisions in bodily injury liability insurance rates, which were approved in December 1972, the medical insurance premium rates had never been approved. *Id.* at 578-79, 242 S.E.2d at 205-06.

256. *Id.* at 579-80, 242 S.E.2d at 206.

257. *Id.* at 582, 242 S.E.2d at 207.

If a policy is issued no more than sixty days prior to its effective date, the standard rule of application generally eliminates the necessity of rewriting or reissuing the policy by permitting the policy to go into effect at its old rate unless the policyholder requests otherwise. This rule has the effect of protecting the policyholder from insurance rate increases occurring after the policy is issued if the policy is issued no more than sixty days prior to its effective date, but it permits the policyholder, if he so requests, to take advantage of rate decreases occurring after the policy is issued but before the policy's effective date.

Id.

258. *Id.* at 587, 242 S.E.2d at 210. The court did not identify the relevant statute, but apparently the reference was to § 58-246(1), which assigned to the Rate Office the function of maintaining rules and regulations and fixing rates for automobile bodily injury insurance. Law of April 4,

followed, the court found the Commissioner's order to be arbitrary and capricious, and affirmed the superior court in setting it aside.²⁵⁹

2. Construction of Policy Terms

In *Woods v. Nationwide Mutual Insurance Co.*,²⁶⁰ the North Carolina Supreme Court for the first time showed a willingness to find some ambiguity in an "apply separately" clause in an insurance policy covering two or more automobiles, and thereby permit stacking, or pyramiding (multiplying the liability limitation in a policy by the number of cars covered). When stacking is recognized, a policy with a \$1000 medical payments limitation on each of three cars could result in a \$3000 claim on a single injury.²⁶¹ Most jurisdictions recognize stacking of medical payment insurance when the named insured owns two or more vehicles, both covered under the same policy.²⁶² The policy reasons for stacking include the special purpose of medical payments insurance, which is to provide a ready fund for the insured without the requirement of establishing fault,²⁶³ and the prevailing rule of resolving any ambiguous language in the policy in favor of the insured.²⁶⁴

In a 1970 split decision, *Wachovia Bank & Trust Co. v. Westchester Fire Insurance Co.*,²⁶⁵ the North Carolina Supreme Court reversed a court of appeals decision that had interpreted the "apply separately" provision in a multiple-automobile liability insurance policy to allow the insured to stack his medical payments coverage. Justice Sharp joined Chief Justice Bobbitt in dissent, agreeing with the court of appeals that the double payment of premiums implied a separate contract on each insured automobile, with consideration owing from the insurer

1939, ch. 394, 1939 N.C. Pub. Laws 859 (formerly codified as amended at N.C. GEN. STAT. § 58-246(1) (1975)) (repealed 1977).

259. 35 N.C. App. at 588, 242 S.E.2d at 211.

A third case, *State ex rel. Comm'r of Ins. v. Motors Ins. Corp.*, 294 N.C. 360, 241 S.E.2d 332 (1978), was dismissed as moot by the supreme court. This appeal was from a 1975 order of the Commissioner revising auto collision insurance rates. Since the order had never become effective because of pending appeals, the new statute and a comprehensive order approving new liability and collision rates mooted the questions raised on the appeal.

260. 295 N.C. 500, 246 S.E.2d 773 (1978).

261. A single insurance policy on two or more automobiles often contains a clause stating that the terms of the policy shall "apply separately" to each automobile. The premiums paid reflect the number of cars covered.

262. See Note, *Insurance—Pyramiding Medical Payment Coverages in Automobile Policies*, 10 WAKE FOREST L. REV. 737 (1974).

263. *Id.* See also *Dyer v. Nationwide Mut. Fire Ins. Co.*, 276 So.2d 6, 7 (Fla. 1973); *Jackson v. Country Mut. Ins. Co.*, 41 Ill. App. 2d 300, 305, 190 N.E.2d 490, 492 (1963).

264. See, e.g., *Duke v. Mutual Life Ins. Co.*, 286 N.C. 244, 210 S.E.2d 187 (1974).

265. 276 N.C. 348, 172 S.E.2d 518 (1970).

on each contract.²⁶⁶ In *Woods* the supreme court, in an opinion written by Chief Justice Sharp, softened the position it had taken in *Wachovia*. Two insurance policies were at issue in *Woods*, each with an "apply separately" provision. Plaintiff Woods was injured while driving a car belonging to one Spencer, who carried on his three cars a policy almost identical to the one construed in *Wachovia*.²⁶⁷ The court did not allow stacking under the Spencer policy, reasoning that even if the independent contract interpretation argued in *Wachovia* had been accepted, it would not apply to this policy, because the coverage-limiting clause referred to injuries to persons "while occupying the owned automobile." The court pointed out that this language unambiguously limits the coverage to a specific vehicle—the owned automobile occupied at the time of the collision.²⁶⁸

The second policy was carried by plaintiff Woods' father on two cars. Under her father's policy, however, plaintiff as a member of the "named insured's" family was entitled to medical payments for bodily injury "caused by accident while occupying or being struck by an automobile."²⁶⁹ Another clause limited the insurer's liability to \$500 per person, creating an ambiguity that, under its usual practice,²⁷⁰ the court resolved against the insurer. Since coverage was not tied to a specific vehicle, the court allowed stacking under the Woods policy, resulting in an additional \$500 recovery. The court carefully distinguished *Wachovia* as a situation in which the remedy tied coverage even of family members to the specific, occupied car.²⁷¹

Policy language so poorly drafted that Justice Lake termed it a "baffling mystery" led the supreme court to reverse a court of appeals dismissal of plaintiff's claim in *Grant v. Emmco Insurance Co.*²⁷² Plaintiff claimed coverage of a leased tractor under a "newly acquired" vehicles provision in an insurance policy covering an owned tractor. Policies extending coverage to "newly acquired" vehicles that replace the vehicle named in a policy generally require that the new vehicles be "owned," which in North Carolina requires a properly executed certificate of title.²⁷³ Plaintiff's policy, however, did not require that the

266. *Id.* at 361, 172 S.E.2d at 527 (Bobbitt, C.J., dissenting).

267. 295 N.C. at 506, 246 S.E.2d at 777-78.

268. *Id.* at 507-08, 246 S.E.2d at 778.

269. *Id.* at 508, 246 S.E.2d at 779 (emphasis by court).

270. *See, e.g.,* *Duke v. Mutual Life Ins. Co.*, 286 N.C. 244, 210 S.E.2d 187 (1974).

271. 295 N.C. at 510, 246 S.E.2d at 780.

272. 295 N.C. 39, 44, 243 S.E.2d 894, 898 (1978).

273. *See* *Nationwide Mut. Ins. Co. v. Hayes*, 276 N.C. 620, 174 S.E.2d 511 (1970).

newly acquired vehicle be owned; because of this silence about leased vehicles, the court found that the tractor came within the meaning of "newly acquired." But, the policy language was ambiguous about whether the newly acquired vehicle, to be covered, had to replace the described vehicle. Although the court could simply have construed this ambiguity against the insurer and found that replacement was not required, it addressed defendant's argument that the leased tractor did not replace the described tractor and was therefore not covered. This argument had convinced two of three judges on the court of appeals.²⁷⁴ The supreme court, recalling its frequently cited decision in *State Farm Mutual Automobile Insurance Co. v. Shaffer*,²⁷⁵ applied the rule of that case to the *Grant* facts. Under *Shaffer*, replacement cannot be found if the described vehicle continues to be owned by the policyholder, under his control and in operable condition;²⁷⁶ the absence of one of these factors allows a finding that the described vehicle has been replaced. The described tractor, although still owned by and under the control of Grant, was undergoing repairs and was not in operable condition during the lease term of the tractor. It therefore did not fall afoul of the *Shaffer* rule.²⁷⁷

3. Construction of Statutory Provisions

In *Caison v. Nationwide Insurance Co.*,²⁷⁸ the court of appeals considered whether the term "permissive use," as used in an insurance policy provision extending coverage to persons using the vehicle with permission of the named insured or his spouse, is synonymous with "lawful possession" as used in G.S. 20-279.21(b)(2),²⁷⁹ which requires that "persons in lawful possession" of the insured vehicle be covered under mandatory liability insurance policies. The policy in *Caison* provided

274. *Grant v. Emmco Ins. Co.*, 35 N.C. App. 246, 241 S.E.2d 114, *rev'd*, 295 N.C. 39, 243 S.E.2d 894 (1978). Judge Webb dissented, finding the policy terms ambiguous.

275. 250 N.C. 45, 108 S.E.2d 49 (1959).

276. *Id.* at 52, 108 S.E.2d at 54.

277. The risk to the insurance company of being liable for damages to two vehicles at the same time, should the described tractor be struck while standing in a garage, was dismissed as minimal. 295 N.C. at 48, 243 S.E.2d at 900.

Defendant's final argument, that ambiguous terms in a collision insurance policy should not be construed against the insurer, was rejected. Defendant cited no authority, but suggested a distinction between liability and collision insurance based on the public policy of requiring the former, as embodied in the Vehicle Financial Responsibility Act, N.C. GEN. STAT. §§ 20-309 to 319 (1978). The court took judicial notice of the custom of providing both collision and liability coverage in the same insurance policy, and said that in both kinds of policies, ambiguous provisions will be construed against the insurer. *Id.* at 54, 243 S.E.2d at 904.

278. 36 N.C. App. 173, 243 S.E.2d 429 (1978).

279. N.C. GEN. STAT. § 20-279.21(b)(2) (1978).

coverage for persons using the insured's car, "provided the actual use of the automobile is by the Named Insured or such spouse or with the permission of either."²⁸⁰ The policy limit on liability for bodily injury was \$25,000 per person, while the statute mandated coverage of the same class only to a \$10,000 limit.²⁸¹ Plaintiff was injured by the insured vehicle, which was driven by a person who was stipulated to be in lawful possession. Upon this stipulation, the trial court granted plaintiff's summary judgment motion and awarded damages in the amount of \$12,000. Defendant appealed, contending that permission and lawful possession are not synonymous, so that the policy coverage for one with permission did not apply to one merely in lawful possession and that plaintiff was therefore limited to a \$10,000 recovery.²⁸²

The court of appeals reversed the trial court's grant of summary judgment, concluding that the terms were not synonymous and that plaintiff could recover an amount in excess of the statutory requirement only when she established that the use of the insured vehicle was with the permission of the insured. Since the additional policy coverage was voluntary, plaintiff had to show that the driver of the insured's car met the terms of the policy (permission) rather than the terms of the statute (lawful possession). The court looked particularly at the terms of G.S. 20-279.21(g),²⁸³ which provides that the excess of additional coverage provided by a policy is governed by the terms of the policy and not by the terms of the statute. This holding is consistent with cases construing the term "lawful possession." It encourages insurers to offer greater coverage than the statute requires, by allowing insurers to limit the class of persons to whom the excess coverage will apply.

In *Turner v. Masias*,²⁸⁵ a contest between insurance companies, the court of appeals was required to interpret the relationship between the

280. 36 N.C. App. at 177, 243 S.E.2d at 431.

281. *Id.* at 176-77, 243 S.E.2d at 430-31. See N.C. GEN. STAT. § 20-279.21(b)(2) (1978).

282. 36 N.C. App. at 175-76, 243 S.E.2d at 430. In *Packer v. Travelers Ins. Co.*, 28 N.C. App. 365, 221 S.E.2d 707 (1976), the court of appeals expressly ruled that permission is not an essential element of lawful possession, so that it is possible to have lawful possession without having permission.

283. N.C. GEN. STAT. § 20-279.21(g) (1978) provides that "such excess or additional coverage shall not be subject to the provisions of this Article."

284. See *Packer v. Travelers Ins. Co.*, 28 N.C. App. 365, 221 S.E.2d 707 (1976), discussed in note 282 *supra*; cf. *Nationwide Mut. Ins. Co. v. Chantos*, 25 N.C. App. 482, 214 S.E.2d 438 (1975), *rev'd on other grounds*, 293 N.C. 431, 238 S.E.2d 597 (1977) (person who had received permission to use vehicle from the original permittee, son of insureds, was deemed to be in "lawful possession"); *Engle v. State Farm Mut. Auto. Ins. Co.*, 37 N.C. App. 127, 245 S.E.2d 532, *cert. denied*, 295 N.C. 645, 248 S.E.2d 250 (1978) (reaffirming *Chantos* as matter of law). The policies in *Chantos* and *Engle* did not provide coverage in excess of the amounts required by statute.

285. 36 N.C. App. 213, 243 S.E.2d 401 (1978).

statutorily required uninsured motorist provision in a liability insurance policy²⁸⁶ and the policy's reduction clause, which provided that payment under the policy should be reduced by the amount paid to the insured by any other policy of property insurance.²⁸⁷ Turner, who had collision insurance with American Security Insurance Co. and liability insurance with Allstate Insurance Co., had recovered under his collision policy the amount of his damages suffered in an accident, less fifty dollars deductible. American later discovered that the driver of the car that had collided with Turner's car was a thief, not in lawful possession of the car; the "uninsured motorist" provision of Turner's liability coverage with Allstate Insurance Co. arguably therefore required payment of insured's damages. Allstate refused to reimburse American on the ground that its reduction clause relieved it of any obligation to pay. American sued, charging that Allstate's reduction clause was unenforceable as violative of the uninsured motorist statute.²⁸⁸

The court held that, although a reduction clause would not be enforced if the result would limit an insured's recovery to an amount less than the actual damages suffered,²⁸⁹ that was not the case here. The purpose of the statute requiring insurance for damage to property caused by uninsured motorists is the protection of the insured, who in this case had already been made whole. Which insurance company paid was not a concern of the statute or of public policy, so Allstate was therefore entitled to have its reduction clause enforced.²⁹⁰

The facts of *Turner v. Masias* made it easy for the court to enforce the reduction clause; Allstate's deductible was \$100, so the insured did better by collecting from American, whose policy deductible was only \$50.²⁹¹ Also, American's policy had no reduction clause.

*Autry v. Aetna Life and Casualty Insurance Co.*²⁹² presented the court of appeals with a question involving the definition of the "uninsured vehicle" as used in the uninsured motorist statute, G.S. 20-279.21(b)(3),²⁹³ the statute providing for mandatory uninsured motorist coverage in liability insurance policies. At issue in *Autry* was inclusion

286. N.C. GEN. STAT. § 20-279.21(b)(3) (1978) requires that mandatory liability insurance policies protect the insured against destruction of their property caused by an owner or operator of an uninsured vehicle.

287. 36 N.C. App. at 214, 243 S.E.2d at 403.

288. *Id.* at 215, 243 S.E.2d at 403.

289. See *Moore v. Hartford Fire Ins. Co.*, 270 N.C. 532, 543, 155 S.E.2d 128, 136 (1967).

290. 36 N.C. App. at 217, 243 S.E.2d at 404.

291. *Id.*

292. 35 N.C. App. 628, 242 S.E.2d 172, cert. denied, 295 N.C. 89, 244 S.E.2d 257 (1978).

293. N.C. GEN. STAT. § 20-279.2(b)(3) (1978).

within the coverage of that statute of a three-wheeled motorcycle powered by a Volkswagen engine; plaintiff was injured by the vehicle in the yard of the vehicle's owner.²⁹⁴ The vehicle was not used on public highways and was therefore not required to be registered.²⁹⁵ The court concluded that the term "uninsured motor vehicle" was intended to include motor vehicles that should be insured but are not, or, though not subject to compulsory insurance, are at some time operated on the public highways.²⁹⁶ As the vehicle met neither of those criteria, it was found not to be an uninsured motor vehicle within the meaning of the statute.²⁹⁷ Plaintiff's liability insurance policy therefore did not provide coverage.²⁹⁸

4. Proof of Loss

In the area of accident insurance,²⁹⁹ insurers have a repertoire of terms that can result in the exclusion of coverage to the disappointment of the insured or his beneficiaries. Courts interpreting such terms are faced with choosing among the strict interpretation urged by the insurer, the liberal interpretation preferred by the plaintiff, or a moderate approach that finds an exception for plaintiff but preserves the exclusion. If the facts of the case are persuasive for plaintiff, even a generally strict court often will follow the third path.

This was the result in both *Dixon v. Mid-South Insurance Co.*³⁰⁰ and *Emanuel v. Colonial Life & Accident Insurance Co.*,³⁰¹ two cases decided by the court of appeals in 1978. In *Dixon*, the insurance policy provided coverage for "accidental bodily injuries."³⁰² The insured died as a result of an air embolism following surgery.³⁰³ Defendant urged that this was not an "accidental means" of injury and sought to persuade the court to apply the strict rule that is triggered by the term "accidental means." Under this rule, "[i]f the result, although unexpected, flows directly from an ordinary act in which the insured voluntarily engages, then such is not deemed to have been produced by

294. 35 N.C. App. at 629, 242 S.E.2d at 173.

295. *Id.* at 629-30, 242 S.E.2d at 174.

296. *Id.* at 632, 242 S.E.2d at 175.

297. *Id.* at 633, 242 S.E.2d at 176.

298. *Id.*

299. The term "accident insurance" is used to include both accident policies and life insurance policies with accident features.

300. 37 N.C. App. 595, 246 S.E.2d 561 (1978).

301. 35 N.C. App. 435, 242 S.E.2d 381 (1978).

302. 37 N.C. App. at 596, 246 S.E.2d at 561.

303. *Id.* at 599, 246 S.E.2d at 563.

accidental means."³⁰⁴ Noting that a contract covering only "injury by accidental means" could easily have been drafted,³⁰⁵ the court found the term "accidental bodily injury" to be synonymous,³⁰⁶ with "accidental injury," a term that requires proof only that the result was unexpected.³⁰⁷ The court also rejected with little comment defendant's argument that the cause of death was not even an accidental injury but a known risk of the surgery undergone by the insured.³⁰⁸

In *Emanuel*, the insurer tried to use another term, "preexisting disease," to escape coverage. The policy excluded losses that were caused or contributed to by any preexisting disease. Plaintiff's decedent was sixty-three when an automobile accident caused fractures of both legs, necessitating surgery; he died a few weeks later of a myocardial infarction to which a preexisting arteriosclerotic condition contributed.³⁰⁹ Plaintiff sued as beneficiary of decedent's policy and obtained summary judgment.

Courts are divided on the proper approach in cases in which both the accident and the disease contribute to the death of the insured.

304. *Mehaffey v. Provident Life & Accident Ins. Co.*, 205 N.C. 701, 705, 172 S.E. 331, 333 (1934). The rule has been applied to deny recovery in various medical settings. *E.g.*, *Fletcher v. Security Life & Trust Co.*, 220 N.C. 148, 16 S.E.2d 687 (1941) (death resulting from spinal anesthesia); *Scott v. Aetna Life Ins. Co.*, 208 N.C. 160, 179 S.E. 434 (1935) (death resulting from blood clot following surgery).

The rule has been criticized by a number of commentators. *See, e.g.*, Clifford, *Survey of North Carolina Case Law—Insurance*, 45 N.C.L. REV. 955, 963-64 (1967); Note, *Insurance—Accidental Means v. Accidental Death or Tweede v. Tweedledee*, 46 N.C.L. REV. 178, 187-88 (1967).

305. Defendant Mid-South clearly knew how to draft such a policy, having done so before. *See Mozingo v. Mid-South Ins. Co.*, 29 N.C. App. 352, 224 S.E.2d 208 (1976).

306. *Hicks v. Old Republic Life Ins. Co.*, 29 N.C. App. 561, 225 S.E.2d 164 (1976), had left unanswered the question of the relationship between the terms "accidental injury," "accidental means," and "accidental bodily injury." In *Hicks*, the insured had fallen from a scaffold, but the autopsy indicated death was caused by a myocardial infarction. *Id.* at 563, 225 S.E.2d at 166. Summary judgment for the defendant, who had insured against "accidental bodily injury," was affirmed.

307. *See, e.g.*, *Henderson v. Hartford Accident & Indem. Co.*, 268 N.C. 129, 132-33, 150 S.E.2d 17, 19-20 (1966); *Fletcher v. Security Life & Trust Co.*, 220 N.C. 148, 150, 16 S.E.2d 687, 688 (1941). *See also Survey of Developments in North Carolina Law, 1976*, 55 N.C.L. REV. 895, 1062 (1977).

308. 37 N.C. App. at 599-600, 246 S.E.2d at 564. The surgery was to remove the insured's left arm and shoulder, a procedure known as a forequarter amputation. The surgery was necessitated by a malignancy under the insured's arm. *Id.* at 598, 246 S.E.2d at 563.

309. The doctor who performed the autopsy stated in deposition that the arteries of Emanuel's heart were "five or six times their normal thickness," but whether "normal" referred to normal for a man of his age or for a younger man was not made clear. 35 N.C. App. at 436, 242 S.E.2d at 382. He also stated that the injuries sustained in the accident, combined with the surgery, forced the heart to increase circulation, and could have caused sufficient stress to initiate the occlusion of the coronary artery. *Id.* Other evidence established that Emanuel's prior physical condition was good, with no history of heart disease. *Id.* at 442, 242 S.E.2d at 385.

Some courts employ a proximate cause analysis, allowing recovery if the accident injuries accelerate the effect of the disease and cause an early death;³¹⁰ other courts deny recovery whenever the disease merely contributes to death.³¹¹ North Carolina follows the latter rule.³¹²

When the preexisting condition is arteriosclerosis as in *Emanuel*, the problem becomes more complicated because there is a question whether arteriosclerosis is a disease, or merely a physical characteristic of aging. The *Emanuel* court declined to rule as a matter of law on the categorization of arteriosclerosis. Three previous North Carolina cases³¹³ that involved insureds whose accident injuries were minor and who had been suffering from longstanding, preexisting arteriosclerosis that in each case at least contributed to death, had all been decided in favor of insurers. The policy in each case had a preexisting disease clause similar to the one in *Emanuel*.

The *Emanuel* court discussed several cases from other jurisdictions in which the question whether arteriosclerosis was a preexisting disease had been submitted to the jury,³¹⁴ and then set forth the factors the jury should consider in making its factual determination.³¹⁵ One factor was the health of the insured prior to the accident; another was the seriousness of the accident. The latter, it seems, should have no bearing on the determination of whether the insured had a preexisting disease. The court noted, however, that in cases denying recovery the arteriosclerotic condition was well-established and the accident usually minor.³¹⁶ Because application of these factors necessarily involves a factual determination, an issue of fact existed requiring reversal of plaintiff's

310. See, e.g., *Preston v. Aetna Life Ins. Co.*, 174 F.2d 10 (7th Cir.), cert. denied, 338 U.S. 829 (1949) (applying Illinois law); *Life & Casualty Ins. Co. v. Jones*, 230 Ark. 979, 328 S.W.2d 118 (1959). But see *Britton v. Prudential Ins. Co.*, 205 Tenn. 726, 732, 330 S.W.2d 326, 328 (1959) ("[I]n accident insurance contracts the liability is measured by the contract, and the doctrine of proximate cause is applicable only in determining whether or not an injury is caused solely by the act or accident . . . while in ordinary negligence cases the proximate cause determines the existence of liability.").

311. See, e.g., *Scharmer v. Occidental Life Ins. Co.*, 349 Mich. 421, 84 N.W.2d 866 (1957); *Adkins v. American Cas. Co.*, 124 S.E.2d 457 (W. Va. 1962).

312. *Penn v. Standard Life Ins. Co.*, 160 N.C. 399, 76 S.E. 262 (1912).

313. *Horn v. Protective Life Ins. Co.*, 265 N.C. 157, 143 S.E.2d 70 (1965); *Skillman v. Phoenix Mut. Ins. Co.*, 258 N.C. 1, 127 S.E.2d 789 (1962); *Hicks v. Old Republic Life Ins. Co.*, 29 N.C. App. 561, 225 S.E.2d 164 (1976).

314. *Preferred Accident Ins. Co. v. Combs*, 76 F.2d 775 (8th Cir. 1935); *Reed v. United States Fidelity & Guar. Co.*, 176 Colo. 568, 491 P.2d 1377 (1971); *Police & Firemen's Ins. Ass'n v. Blunk*, 107 Ind. App. 279, 20 N.E.2d 660 (1939); *Novick v. Commercial Travelers Mut. Accident Ass'n*, 203 Misc. 830, 118 N.Y.S.2d 533 (1953).

315. 35 N.C. App. at 449, 242 S.E.2d at 389.

316. *Id.* at 448, 242 S.E.2d at 389.

judgment and remand for trial.³¹⁷

The court was also correct in affirming the denial of defendant's motion for summary judgment, observing that "to hold otherwise would allow insurance companies to escape liability under an accident policy any time an insured dies as a result of injuries received in an accident, but is also suffering from even a normal degree of arteriosclerosis which may contribute to the accidental death."³¹⁸ Considering the strict North Carolina rule denying recovery whenever a preexisting disease contributes to death, it is fortunate that the court did not rule as a matter of law in defendant's favor. Affirming plaintiff's summary judgment would have taken the court further than other jurisdictions have gone on this difficult issue.³¹⁹

K. *Workmen's Compensation Law*

1. Application of the Compensation Act

It is well settled in North Carolina that, in a claim by an employee against a workmen's compensation insurance carrier, the carrier may be estopped from denying that an injury to the employee was within the coverage of the compensation insurance policy.³²⁰ In *Britt v. Colony Construction Co.*,³²¹ the North Carolina Court of Appeals extended this principle to a situation involving coordination of benefits between two separate compensation carriers.

Plaintiff's decedent, Britt, was employed by Cumberland Utilities,

317. 35 N.C. App. at 449, 242 S.E.2d at 389. In a later case, *McAdams v. Union Security Life Ins. Co.*, 36 N.C. App. 463, 244 S.E.2d 692 (1978), the court affirmed a directed verdict for defendant, whose insurance policy excluded coverage of any disability to which a preexisting sickness contributed. *Id.* at 464, 244 S.E.2d at 693. Distinguishing *Emanuel*, the court stressed that all of the evidence in *McAdams* indicated a previously diagnosed condition of arteriosclerotic heart disease with coronary insufficiency, and not simple arteriosclerosis. *Id.* at 469, 244 S.E.2d at 695-96. The insurance policy in this case covered installment payments on an automobile in case the insured, because of disability by accident or sickness, became unable to continue the payments.

The court also rejected plaintiff's argument that his condition was a "disease" and not a "sickness" within the meaning of the policy exception, citing *Glenn v. Gate City Life Ins. Co.*, 220 N.C. 672, 676, 18 S.E.2d 113, 115 (1942), in which "disease" and "sickness" were deemed synonymous absent some indication of the parties' contrary intent. 36 N.C. App. at 468, 244 S.E.2d at 695.

318. *Id.* at 442, 242 S.E.2d at 385.

319. See Annot., 82 A.L.R.2d 611 (1962)(usual conclusion reached is that right of arteriosclerotic insured (or his beneficiary) to enforce policy is one for trier of fact).

320. See *Aldridge v. Foil Motor Co.*, 262 N.C. 248, 136 S.E.2d 591 (1964); *Pearson v. Newt Pearson, Inc.*, 222 N.C. 69, 21 S.E.2d 879 (1942). The theory is that, having accepted premiums for coverage of the employee, the carrier should not be permitted to disclaim liability after the employee is injured.

321. 35 N.C. App. 23, 240 S.E.2d 479 (1978).

Incorporated, a subcontractor of Colony Construction Company on a highway construction project.³²² During performance of the work covered by the subcontract, Utilities paid Britt for work done on other, unrelated projects, and maintained workmen's compensation insurance for him.³²³ Colony paid Britt directly for work done under the subcontract, and withheld funds actually owed to Utilities in order to pay workmen's compensation premiums on Utilities' employees.³²⁴ Britt died from injuries sustained while working on the Colony project, and his dependents instituted a proceeding under the Workmen's Compensation Act.³²⁵

The court of appeals affirmed the Industrial Commission's finding that Britt was Utilities' employee³²⁶ and that Utilities and its carrier, Aetna Insurance Company, should pay benefits pursuant to the applicable statute.³²⁷ But the court also accepted Aetna's contention that

322. Colony was primarily a grading contractor, and subcontracted with Utilities because of Utilities' expertise in installing water pipe. To avoid the "red tape" involved in making Utilities an "official" subcontractor under state law, Colony and Utilities entered into a contract under which Utilities would furnish all labor, equipment, organization and incidental tools, and Colony would furnish the materials. Colony paid Utilities on a monthly basis for work performed, less 10% retainage, less the gross amount of payroll paid to employees supplied by Utilities, and less a 17% deduction based on the gross payroll to cover payroll taxes, workmen's compensation premiums for Utilities' employees and other insurance paid by Colony. *Id.* at 25-27, 240 S.E.2d at 480-81.

323. *Id.* at 28, 240 S.E.2d at 482.

324. *See* note 322 *supra*.

325. N.C. GEN. STAT. § 97-38, -39 (1972 & Cum. Supp. 1977).

326. Although members of the work crew, including Britt, were listed on Colony's payroll, reported on Colony's W-2 and W-4 forms, and directly paid by Colony, the Industrial Commission found that Utilities had hired the crew, that Utilities determined the composition, classification, and weekly pay rates of the crew, that Utilities controlled the actual performance of the crew, and that only Utilities' foreman could hire and fire crew members. 35 N.C. App. at 26-28, 240 S.E.2d at 481-82. The court of appeals found that the only supervision Colony exercised over the crew was to see that their work met United States Department of Transportation specifications. *Id.* at 31, 240 S.E.2d at 484. In cases involving lent employees, or dual employment, liability for injury to the employee is generally determined by resolving the issue of which employer had the right to control the employee's work. *Lewis v. Barnhill*, 267 N.C. 457, 148 S.E.2d 536 (1966). *See* 1B A. LARSON, WORKMEN'S COMPENSATION LAW § 44.00 (1978). "The traditional test of the employer-employee relation is the right of the employer to control the details of the work." *Id.* *See generally id.* §§ 48.00-23.

327. N.C. GEN. STAT. § 97-38 (Cum. Supp. 1977) bases death benefits for dependents on a percentage of the deceased employee's average weekly wages at the time of the accident. The "average weekly wages" are the earnings of the injured employee in the employment in which he was working at the time of his injury. *Id.* § 97-2(5) (Cum. Supp. 1977). Thus, compensation for an employee who holds two separate jobs must be based exclusively upon his average weekly wages in the job in which he was injured. *See Joyner v. A.J. Carey Oil Co.*, 266 N.C. 519, 146 S.E.2d 447 (1966); *Barnhardt v. Yellow Cab Co.*, 266 N.C. 419, 146 S.E.2d 479 (1966). For criticism of this method of determining average weekly wages, see Note, *Workmen's Compensation—Average Weekly Wage—Combination of Wages*, 44 N.C.L. REV. 1177 (1966). The court of appeals in *Britt* agreed with the Commission's finding that Britt held only one job but was paid for that job on two separate payrolls. 35 N.C. App. at 29, 240 S.E.2d at 483.

Colony and its carrier, Standard Fire Insurance Company, were estopped from denying that the employer-employee relationship existed between Colony and Britt, and that Colony and Standard Fire should pay a part of the benefits awarded to plaintiffs.³²⁸ The court said Standard Fire could not escape all liability if it had accepted the premiums collected by Colony for workmen's compensation insurance on Britt's wages.³²⁹ The case was, therefore, remanded to the Industrial Commission for its finding on Standard Fire's acceptance or nonacceptance of the premiums.³³⁰

The *Britt* decision represents a pragmatic and equitable response to an unusual problem. In the ordinary case of dual employment, the employer that furnishes its employee and equipment to another employer, and retains control over the employee, remains liable for any and all injuries to that employee.³³¹ The court in *Britt* adhered to the essence of this rule, since it placed the primary responsibility for compensation on Utilities and its insurance carrier.³³² Colony's carrier was to contribute only if it was proved that it had accepted premium payments withheld by Colony for the benefit of Britt.³³³ The general rule governing dual employment was thus made to accommodate the equitable principle that a workmen's compensation carrier should not totally avoid a liability that it has been paid to accept.³³⁴ Indeed, there is no reason why a rule that would hold Utilities and its insurance carrier solely responsible for benefits should not give way when economic realities compel a different result. Britt's dependents will be fully compen-

328. 35 N.C. App. at 32, 240 S.E.2d at 484. The Industrial Commission had awarded plaintiffs benefits based on the wages earned by Britt while in the employ of Utilities, including the wages Utilities paid directly and those paid indirectly through Colony. *Id.* at 29, 240 S.E.2d at 483. Thus Utilities' carrier was to pay benefits based on wages Colony actually paid and against which Colony had taken a deduction for workmen's compensation insurance.

329. *Id.* at 33, 240 S.E.2d at 485.

330. *Id.* The formula for Standard Fire's contribution, if the premiums were accepted, is the proportion that the wages paid Britt by Colony bear to his total wages for the period of time during which he worked for both employers. *Id.*

331. *Lewis v. Barnhill*, 267 N.C. 457, 148 S.E.2d 536 (1966). *But see* N.C. GEN. STAT. § 97-51 (1972) (providing that when employee is in joint service of two or more employers at time he is injured, each employer shall contribute to employee's compensation in proportion to wages each paid the employee). *Britt* was not a joint employment case under § 97-51, since the Industrial Commission found, and the court agreed, that Britt was Utilities' employee. This finding foreclosed the possibility that Utilities and Colony would be jointly liable for benefits to Britt's dependents under § 97-51. 35 N.C. App. at 33, 240 S.E.2d at 485. *See also* *Collins v. James Paul Edwards, Inc.*, 21 N.C. App. 455, 204 S.E.2d 873, *cert. denied*, 285 N.C. 589, 206 S.E.2d 862 (1974).

332. 35 N.C. App. at 33, 240 S.E.2d at 485.

333. *Id.*

334. *Id.*

sated in any event. As a matter of policy, they should be compensated by those who were paid to accept the risk.

2. Third-Party Liability of Carriers

Under G.S. 97-10.1, once an employer and employee are subject to and comply with the Workmen's Compensation Act,³³⁵ the employee has no right of action against the employer "at common law or otherwise" on account of work-related injury or death.³³⁶ The employee's right to sue a third party, however, is unaffected by the Act.³³⁷ The most important legal issue arising in this area of third-party tort liability is whether, when the applicable statute neither identifies the insurer with the employer nor indicates that the insurer should not be treated as a third party, a workmen's compensation insurance carrier may be sued for negligence in the performance of such functions as making safety inspections.³³⁸ In *Smith v. Liberty Mutual Insurance Co.*,³³⁹ a federal district court, on reconsideration of a prior opinion,³⁴⁰ determined that under the North Carolina Act, which does not specify the insurer's status, the insurance carrier is not to be considered a third party suable for negligence under common law.³⁴¹ The court held that tort immunity is conferred upon the insurer by virtue of the provisions of G.S. 97-9³⁴² and G.S. 97-10.1,³⁴³ which protect both the employer and those conducting his business.³⁴⁴

Plaintiff in *Smith* had been seriously injured while operating a loom at a plant for which Liberty Mutual was the workmen's compensation insurance carrier.³⁴⁵ In her civil suit for damages against Liberty

335. N.C. GEN. STAT. §§ 97-1 to -101 (1972 & Cum. Supp. 1977).

336. *Id.* § 97-10.1 (Cum. Supp. 1977). For general rule, see 2A A. LARSON, *supra* note 326, § 65.10 (1976). In some states, an employer subject to a workmen's compensation act may be sued when the injured employee is an illegally employed minor, or when the employee's injury was occasioned by the employer's wilful misconduct or failure to provide safety devices. *Id.* § 67.21. *But see* N.C. GEN. STAT. §§ 97-10.3, -12 (1972 & Cum. Supp. 1977).

337. N.C. GEN. STAT. § 97-10.2 (1972).

338. *See* Larson, *Workmen's Compensation Insurer as Suable Third Party*, 1969 DUKE L.J. 1117, 1117-18.

339. 449 F. Supp. 928 (M.D.N.C. 1978).

340. The original opinion appears at 409 F. Supp. 1211 (M.D.N.C. 1976), *discussed in* *Survey of Developments in North Carolina Law*, 1976, 55 N.C.L. REV. 895, 1118-20 (1977).

341. 449 F. Supp. at 934.

342. N.C. GEN. STAT. § 97-9 (Cum. Supp. 1977).

343. *Id.* § 97-10.1.

344. 449 F. Supp. at 934. North Carolina courts have held that the employee's exclusive remedy against the employer under the Act is extended to "those conducting [the employer's] business" by § 97-9. *See, e.g.,* *Weaver v. Bennett*, 259 N.C. 16, 129 S.E.2d 610 (1963).

345. 449 F. Supp. at 929.

Mutual, plaintiff alleged defendant was negligent in failing to exercise reasonable care in performing safety inspections at the facility.³⁴⁶ Defendant's motion for summary judgment asserted that the exclusive remedies provided under the Workmen's Compensation Act barred plaintiff's tort claim.³⁴⁷ This assertion was based on defendant's argument that an insurer is the equivalent of the employer for purposes of the Act.³⁴⁸

Defendant's argument was rejected when the district court first heard the case in 1976.³⁴⁹ At that time, the court could find no controlling North Carolina decisions.³⁵⁰ It therefore examined the relevant statutory provisions, noting initially that the statute's definition of "employer" does not include the employer's insurance carrier, which is instead separately defined in another section.³⁵¹ The court then noted that North Carolina courts have extended the employer's tort immunity to those conducting his business, but have never directly addressed the issue whether the insurance carrier falls within the employer category.³⁵² The district court then declined to decide the issue, stating that it would be premature to make the findings of fact necessary to resolve the issue on a motion for summary judgment.³⁵³

On reconsideration of defendant's motion, the district court decided to resolve the issue. To determine whether the insured is to be treated as an employer or one of those conducting his business, and is thus entitled to the statutory protection of G.S. 97-9 and G.S. 97-10.1, the court relied on two North Carolina Supreme Court decisions that it had overlooked when it previously addressed the issue.³⁵⁴ In *Hoover v.*

346. *Id.*

347. *Id.* at 930.

348. *Id.*

349. 409 F. Supp. 1211, 1218-19 (M.D.N.C. 1976).

350. In several states having statutes similar to the North Carolina Act, courts have read into the statutes a proscription against third-party tort liability for workmen's compensation insurance carriers. See *Horne v. Security Mut. Cas. Co.*, 265 F. Supp. 379 (D. Ark. 1967). Other courts considering similar statutes have concluded that if the carriers are to receive the same protection as employers, it is for the legislature to say so. See *Beasley v. MacDonald Eng'r Co.*, 287 Ala. 189, 249 So. 2d 844 (1971).

351. 409 F. Supp. at 1215.

352. *Id.* The court noted that North Carolina courts have given § 97-9 protection to employees, officers and agents of the employer as those conducting the employer's business. See, e.g., *Altman v. Sanders*, 267 N.C. 158, 148 S.E.2d 21 (1966); *Essick v. Lexington*, 232 N.C. 200, 60 S.E.2d 106 (1950). But North Carolina courts have denied the protection of § 97-9 to independent contractors performing work on the employer's premises but having no connection with the employment relationship. See *Lewis v. Barnhill*, 267 N.C. 457, 148 S.E.2d 536 (1966).

353. 409 F. Supp. at 1216. For the court's treatment of other arguments made by the insurer, see *Survey of Developments in North Carolina Law, 1976*, *supra* note 340, at 1119 nn.28 & 31.

354. 449 F. Supp. at 931.

Globe Indemnity Co.,³⁵⁵ the North Carolina Supreme Court extended to the employer's compensation carrier the protection of G.S. 97-26,³⁵⁶ which provides that the employer shall not be liable in damages for the malpractice of a physician furnished by him. The *Smith* court read this case as establishing an identity between the employer and the insurance carrier.³⁵⁷ Whether *Hoover* can support such a broad reading is questionable. The *Hoover* court decided only that an employee cannot sue the employer or the carrier for malpractice by a physician furnished to treat the job-related injury.³⁵⁸ *Hoover* should be read, therefore, as protecting the carrier against suit only when an allegedly negligent third party, the physician, is involved, because the issue of a carrier's tort liability for its independent negligent act was not before the court. The *Smith* court, however, not only used *Hoover* to support the broader proposition of absolute tort immunity for the carrier, but also relied on dictum in a second *Hoover* opinion to buttress its position.

In the second *Hoover* opinion,³⁵⁹ the North Carolina Supreme Court observed that were the insurance carrier liable to plaintiff for malpractice by a physician in the carrier's employ, "it would seem that the North Carolina Industrial Commission would have jurisdiction"³⁶⁰ Because the Industrial Commission has no jurisdiction over a claim against a third party, the *Smith* court concluded that the supreme court thought the carrier was not a third party suable for negligence at common law.³⁶¹ The district court insisted that this "holding" implicitly extended the employer's protection to the carrier, as one conducting the employer's business.³⁶² The *Hoover* court, however, did not hold that the employee's exclusive remedy against a negligent carrier is within the jurisdiction of the Industrial Commission, because that issue was not before the court for resolution.³⁶³

355. 202 N.C. 655, 163 S.E. 758 (1932).

356. N.C. GEN. STAT. § 97-26 (1972).

357. 449 F. Supp. at 932, 934.

358. 202 N.C. at 657, 163 S.E. at 759. *Hoover* held that an injury sustained by the employee as a result of negligent treatment by a physician furnished by the employer or the carrier is a constituent element of the employee's original injury, and is therefore compensable only under the Act. *Id.*

359. 206 N.C. 468, 174 S.E. 308 (1934).

360. *Id.* at 470, 174 S.E. at 309.

361. 449 F. Supp. at 933.

362. *Id.* at 934.

363. The only issue before the *Hoover* court was whether the insurer could be liable in tort for the acts of a negligent agent (a physician) when the agent's wrongful act was outside the scope of his employment, and was not ratified or authorized by the insurer. 206 N.C. at 470, 174 S.E. at 319.

The *Hoover* opinions clearly did not constitute "persuasive authority" to support the district court's conclusion that an insurance carrier is not a third party within the meaning of G.S. 97-10.2 and therefore is immune to suit by virtue of G.S. 97-9 and 97-10.1. Neither opinion even approached the conclusion that an insurer, as one conducting the employer's business, is generally immune from tort liability for its own negligent acts. The *Smith* court, by purporting to derive that conclusion from the opinions, effectively circumvented its inability, on a summary judgement motion, to make an express finding of fact that an insurer is the employer's agent, rather than an independent contractor, and thus entitled to the protection afforded those conducting the employer's business.

The *Smith* decision can be seriously faulted for its reliance on questionable precedent to construe broadly the term "carrier" in the absence of any indication that the legislature intended such a broad construction.³⁶⁴ Whether the workmen's compensation insurance carrier should be liable in tort for negligence in the performance of safety inspections would, ideally, involve an inquiry into the function of the insurance carrier, as well as a balancing of public policy objectives.³⁶⁵ The functional analysis would draw a distinction between the insurer as payor of benefits under the Act, and as provider of other services related to the Act, such as performing safety inspections.³⁶⁶ It is certainly arguable that the insurer should be liable in tort for negligence in performance of its role as safety inspector.³⁶⁷ But this is a public policy argument and turns on facts that should be investigated by the legisla-

364. Twenty-two state statutes specifically equate employers and their insurance carriers and exempt both from third-party tort liability. See COLO. REV. STAT. § 8-42-102 (Cum. Supp. 1976); DEL. CODE ANN. tit. 19, § 2301(8) (1975); FLA. STAT. ANN. § 440.11 (West 1977); GA. CODE ANN. § 114-101 (1973); HAW. REV. STAT. § 386-1 (1976); ILL. ANN. STAT. ch. 48, § 138.5 (Smith-Hurd Cum. Supp. 1978); IND. ANN. STAT. § 22-3-2-5 (Cum. Supp. 1978); IOWA CODE § 85A-15 (Cum. Supp. 1978-1979); ME. REV. STAT. ANN. tit. 39, § 2(6) (1964); MICH. STAT. ANN. § 17.237 (13) (Cum. Supp. 1975); MO. ANN. STAT. § 287.030.2 (Vernon 1965); NEB. REV. STAT. § 48-111 (1968); N.H. REV. STAT. ANN. § 281:2 (1966); N.M. STAT. ANN. § 59-10-4(D) (Supp. 1975); OR. REV. STAT. § 656.018(3) (1973-1974); PA. STAT. ANN. tit. 77, 501 (Cum. Supp. 1978-1979); S.D. COMPILED LAWS ANN. § 62-1-2 (1978); TENN. CODE ANN. § 50-902(a) (Cum. Supp. 1978); TEX. REV. CIV. STAT. ANN. art. 8306, § 3 (Vernon Cum. Supp. 1967); VT. STAT. ANN. tit. 21, § 601(3) (1967); VA. CODE ANN. § 65-3 (1950); WIS. STAT. ANN. § 102.03(2) (West Cum. Supp. 1973). The provisions in the Illinois, Michigan and New Hampshire statutes were all added to protect insurance carriers after court decisions had held the carriers liable as third parties.

365. See 2A A. LARSON, *supra* note 326, § 72.90 (1976).

366. The distinction is between "paying for services and physically performing them It is virtually impossible to cause physical injury by writing a check. It is very possible to cause physical injury . . . by making a safety inspection." 2A *id.* The functional approach has been applied in *Sims v. American Cas. Co.*, 131 Ga. App. 461, 206 S.E.2d 121, *aff'd per curiam*, 232 Ga. 787, 209 S.E.2d 61 (1974).

367. See 2A A. LARSON, *supra* note 326, § 72.90 (1976).

ture before subjecting insurers who assume this role to potential tort liability.³⁶⁸ One court has speculated, for example, that insurers will avoid tort liability altogether by not making safety inspections unless required by law to do so, and that the "ultimate losers will be workmen and their families."³⁶⁹ This assertion has been countered by the response that the insurers' economic self-interest would be great enough to overcome the fear of potential tort liability.³⁷⁰ Another court has admonished that no safety inspection at all is preferable to a negligent one.³⁷¹ The legislature is uniquely capable of determining whether insurance carriers do discontinue safety inspections when confronted with potential tort liability, and, if so, whether there are other ways to get the job done.³⁷² It is not too late for a responsible resolution of this difficult issue.

3. Compensable Injuries

a. By Accident, Arising Out of and In the Course of Employment

To recover under the North Carolina Workmen's Compensation Act, the claimant must show that an injury resulted from an accident³⁷³ arising out of and in the course of employment.³⁷⁴ The accident "arises out of" the employment when it occurs in the course of employment and is the result of a risk incident to the employment.³⁷⁵ The words "in the course of" have reference to the time, place and circumstances

368. *Id.*

369. *Kotarski v. Aetna Cas. & Sur. Co.*, 244 F. Supp. 547, 558-59 (E.D. Mich. 1965), *aff'd per curiam*, 372 F.2d 95 (6th Cir. 1967).

370. *Mays v. Liberty Mut. Ins. Co.*, 323 F.2d 174, 178 (3d Cir. 1963).

371. *Fabricius v. Montgomery Elev. Co.*, 254 Iowa 1319, 1327, 121 N.W.2d 361, 366 (1963).

372. *See* 2A A. LARSON, *supra* note 326, § 72.90 (1976).

373. "The basic and indispensable ingredient of 'accident' is unexpectedness." 1B *id.* § 6 (1978). North Carolina courts remain in the minority by also requiring that the accident arise from unusual exertion. Three recent cases apply this minority rule. *Curtis v. Carolina Mechanical Sys., Inc.*, 36 N.C. App. 621, 244 S.E.2d 690 (1978) (compensation denied for hernia suffered when employee received injury while doing his usual duties in usual way); *Searsey v. Perry M. Alexander Constr. Co.*, 35 N.C. App. 78, 239 S.E.2d 847, *cert. denied*, 294 N.C. 736, 244 S.E.2d 154 (1978) (compensation allowed for back injury sustained while employee did unusual task); *Smith v. Burlington Indus., Inc.*, 35 N.C. App. 105, 239 S.E.2d 845 (1978) (compensation denied for back injury suffered when employee was doing his customary work in usual way).

374. *Bell v. Dewey Bros.*, 236 N.C. 280, 72 S.E.2d 680 (1952); *see* N.C. GEN. STAT. § 97-2(6) (Cum. Supp. 1977).

375. There must be some causal connection between the employment and the injury. *Bolling v. Belk-White Co.*, 228 N.C. 749, 750, 46 S.E.2d 838, 839 (1948). This does not mean, however, that the accident must have been caused by the employment. *Harless v. Flynn*, 1 N.C. App. 448, 162 S.E.2d 47 (1968). It does require a showing that an injury was caused by an increased risk "to which claimant as distinct from the general public, was subjected by his employment." 1 A. LARSON, *supra* note 326, § 6.

under which the accident occurs.³⁷⁶

In *Martin v. Bonclarken Assembly*,³⁷⁷ the North Carolina Court of Appeals affirmed an award to dependents of a fifteen-year old laborer who drowned while swimming on his employer's premises during his lunch hour.³⁷⁸ Although the employee had his employer's permission to use the swimming facilities when off-duty, regulations prohibited swimming during the lunch hour because the lifeguard was also off-duty.³⁷⁹ Because no one had alerted the employee to these regulations,³⁸⁰ the court agreed with the Industrial Commission that the death had occurred under compensable circumstances.³⁸¹ In allowing recovery, the court distinguished several cases in which recovery had been denied because the employee had disobeyed express orders of the employer,³⁸² and made it clear that only violations of express prohibitions

376. *Harless v. Flynn*, 1 N.C. App. 448, 162 S.E.2d 47 (1968). See generally 1 A. LARSON, *supra* note 326, § 14; 1A *id.* § 29.

377. 35 N.C. App. 489, 241 S.E.2d 848, cert. granted, 295 N.C. 91, 244 S.E.2d 258 (1978).

378. Recreational injuries during the noon hour on the premises of the employer have been held compensable in the majority of cases. The presence of the activity on the employer's premises is of great importance. 1A A. LARSON, *supra* note 326, § 22.11; see *Watkins v. City of Wilmington*, 290 N.C. 276, 225 S.E.2d 577 (1976). But compensation is generally withheld for injuries received during recreational activities off the employer's premises when the employee was not required to participate. See *Perry v. American Bakeries Co.*, 262 N.C. 272, 136 S.E.2d 643 (1964); *Burton v. American Nat'l Ins. Co.*, 10 N.C. App. 499, 179 S.E.2d 7 (1971).

379. 35 N.C. App. at 490, 241 S.E.2d at 849.

380. Plaintiff's decedent had actually violated two regulations. One prohibited swimming when the lifeguard was off-duty; the other required a swimming test before swimming beyond the chained area of the lake. A sign posted at the lake, which should have been seen by Martin, did not state that the lake was closed when the lifeguard was off-duty. It did, however, state clearly that a swimming test was required for swimming beyond the chained area. The court, however, agreed with the Industrial Commission that Martin could have reasonably assumed he was within the chained area since he was unfamiliar with the lake and was within the roped area. *Id.* at 490-92, 241 S.E.2d at 849-50.

381. *Id.* at 492-93, 241 S.E.2d at 851. The court concluded that the accident arose out of decedent's employment because it was the result of a risk incident to the employment and not from a hazard common to the public. The public was not invited to swim in defendant's lake, but employees of Assembly were. *Id.* The court also found that the "time," "place," and "circumstance" conditions of the "in the course of employment" test were fulfilled. With respect to time and place, decedent drowned during his lunch hour on the employer's premises. With respect to circumstances, decedent was "doing what a man so employed may reasonably do within a time which he is employed, and at a place where he may reasonably be during that time to do that thing." *Id.* at 493, 241 S.E.2d at 851.

382. *Id.* at 493, 241 S.E.2d at 851 (distinguishing *Morrow v. State Highway & Public Works Comm'n*, 214 N.C. 835, 199 S.E.2d 265 (1938) (deceased jumped into river to recover paint brush after having been told not to do so by his employer); *Teague v. Atlantic Co.*, 213 N.C. 546, 196 S.E. 875 (1938) (employee tried to ride a crate conveyor instead of using the stairs, contrary to the rules of his employer)).

Generally, an accident is considered to have been in the course of employment even though it resulted from the employee's violation of an express prohibition or regulation, if that prohibition or regulation related to the *method* of accomplishing the employee's job, rather than to the boundaries defining the *ultimate work* to be done. A prohibited overstepping of those boundaries will

communicated to the employee³⁸³ will preclude recovery for injuries sustained on the employer's premises in activities that are outside the employee's regular duties.³⁸⁴

The decision should serve to remind employers of their responsibility to warn employees if certain conduct, incidental to accomplishment of their jobs, is prohibited.³⁸⁵ In light of the practical difficulty of ensuring that all employees are fully aware of regulations governing the use of such facilities, the decision may also serve to discourage employers from providing on-premises recreational facilities for employees' off-duty use.³⁸⁶

b. Extent of Incapacity for Work

Under the Workmen's Compensation Act, a claimant's degree of disability is measured by her capacity to earn the wages she was receiv-

remove the accident from the course of employment. 1A A. LARSON, *supra* note 326, § 31.00. *Morrow* and *Teague* fall outside these general rules, and serve to illustrate an exception noted by Larson. That exception recognizes that compensation should be denied in situations where the employer has taken thorough precautions to keep employees from places of extreme danger, and the employee's act in subjecting himself to the danger is inexplicable and little related to any reasonable necessity in connection with the accomplishment of his work. *Id.* § 31.23.

383. 35 N.C. App. at 492-93, 241 S.E.2d at 851.

384. See 1A A. LARSON, *supra* note 326, § 31.00. ("Violations of express prohibitions relating to incidental activities, such as seeking personal comfort, as distinguished from activities contributing directly to the accomplishment of the main job, are an interruption of the course of employment.").

385. The court of appeals denied recovery in *Hensley v. Caswell Action Comm.*, 35 N.C. App. 544, 241 S.E.2d 852 (1978), *rev'd*, 296 N.C. 527, 251 S.E.2d 399 (1979), an employee drowning case heard the same term as *Martin*. In *Hensley*, a 14 year old laborer drowned while wading across a reservoir to cut weeds on the other side. Because the boy had disobeyed instructions not to go in the water, the court of appeals found there was no causal connection between the employment and the accident. The supreme court held that the causal connection had not been severed, and reversed, 296 N.C. 527, 251 S.E.2d 399 (1979). The supreme court noted that the young boy was engaged in his assigned task at the time of the drowning, had received only general instructions not to go in the water, and had not been confronted with an obvious danger since the water appeared shallow. *Id.* at 531, 251 S.E.2d at 401. The court distinguished both *Morrow v. State Highway & Public Works Comm'n*, 214 N.C. 835, 199 S.E.2d 265 (1938), and *Teague v. Atlantic Co.*, 213 N.C. 546, 196 S.E. 875 (1938), as cases in which the employee's misconduct involved thrill-seeking because of the obvious danger of violating the employer's warning. *Id.* at 530-31, 251 S.E.2d at 401. *Hensley* comports with the general rule discussed by Larson—that compensation will not be denied an employee who violates a rule related to the method of accomplishing the employee's ultimate task. See note 382 *supra*. *Hensley* had been assigned the task of cutting weeds at the edge of a reservoir, and was to walk around the edge in order to do so. The method he employed—wading across the reservoir—merely departed from the method prescribed by his employer.

386. Such difficulties were apparent in *Martin*. Defendants had both a resident staff and paid laborers on the premises. All regulations were distributed to the resident staff at an orientation session. The lake regulations were posted on a sign to reach those who did not attend the orientation. But the sign suggested that the lifeguard was on-duty at a time when he was not. 35 N.C. App. at 490, 241 S.E.2d at 849.

ing at the time of her injury.³⁸⁷ A claimant unable to work and earn any wages is compensated for total disability³⁸⁸ unless all her injuries are included in the schedule set out in G.S. 97-31, in which case compensation is exclusively under that statute.³⁸⁹ A claimant able to work and earn some wages, but less than she was receiving at the time of her injury, is considered partially disabled and entitled to compensation under G.S. 97-31 for any injuries listed in that schedule and to compensation under G.S. 97-30 for any impairment of wage earning capacity caused by injuries not listed in the schedule.³⁹⁰

Plaintiff in *Little v. Anson County Schools Food Service*³⁹¹ challenged an award for partial loss of use of her back under G.S. 97-31(23),³⁹² alleging that she suffered additional impairments.³⁹³ The North Carolina Supreme Court remanded the case because the Industrial Commission had failed to consider all plaintiff's injuries in its award,³⁹⁴ and had not heard plaintiff's evidence on total disability.³⁹⁵

387. *Dail v. Kellex Corp.*, 233 N.C. 446, 64 S.E.2d 438 (1951); see N.C. GEN. STAT. § 97-2(9) (1972).

388. N.C. GEN. STAT. § 97-29 (Cum. Supp. 1977). Disability as used in the North Carolina Act means impairment of wage earning capacity rather than physical impairment. *Priddy v. Blue Bird Cab Co.*, 9 N.C. App. 291, 176 S.E.2d 26 (1970).

389. N.C. GEN. STAT. § 97-31 (Cum. Supp. 1977); see *Loflin v. Loflin*, 13 N.C. App. 574, 186 S.E.2d 660, cert. denied, 281 N.C. 154, 187 S.E.2d 585 (1972). If an injury is one of those enumerated in the schedule of payments set forth in § 97-31, compensation is made pursuant to that schedule, without regard to loss of wage earning power and in lieu of all other compensation. *Id.* at 578, 186 S.E.2d at 663. But see 2 A. LARSON, *supra* note 326, § 58.20 (1976), in which the multiple impairment principle, recognized in a number of newer decisions, is discussed. The principle would recognize that "when two or more schedule injuries occur together, the disabling effect may be far greater than the arithmetical total of the schedule allowances added together." *Id.* In *Berg v. Sadler*, 235 Minn. 214, 50 N.W.2d 266 (1951), claimant, a road and farm worker, sustained a 40% disability of one foot and ankle and a 75% disability of the other foot and ankle. Since he could do no work involving standing or walking or use of his feet, "it seems plain enough that merely putting end-to-end the fractional schedule allowances for the two feet would be a gross miscarriage of the concept of compensable disability. The Minnesota Supreme Court, overruling the Commission, awarded total permanent disability benefits." 2 A. LARSON, *supra*.

390. N.C. GEN. STAT. § 97-30, -31 (Cum. Supp. 1977).

391. 295 N.C. 527, 246 S.E.2d 743 (1978).

392. N.C. GEN. STAT. § 97-31(23) (Cum. Supp. 1977).

393. The uncontradicted evidence tended to show that "an injury to plaintiff's spinal cord ha[d] resulted in weakness in *all of her extremities*, and numbness or loss of sensation *throughout her body*." 295 N.C. at 531-32, 246 S.E.2d at 745.

394. *Id.* at 531, 246 S.E.2d at 746.

395. Plaintiff had not presented evidence of total disability at her first hearing because a deputy commissioner told her such testimony was unnecessary. *Id.* at 532, 246 S.E.2d at 746. Under N.C. GEN. STAT. § 97-84 (1972), a claimant must have a full opportunity to be heard. Because plaintiff refrained from presenting evidence in reliance on an inaccurate statement by a deputy commissioner, the right guaranteed by the statute was abridged. In workmen's compensation cases the claimant generally bears the burden of proving the degree of disability suffered. *Hall v. Thomson Chevrolet, Inc.*, 263 N.C. 569, 139 S.E.2d 857 (1965). But see 2 A. LARSON, *supra* note 326, § 57.61, which suggests that the burden of proof shifts in certain circumstances:

The court made it clear that, if the Commission found that all plaintiff's injuries were included in the G.S. 97-31 schedule, compensation was to be exclusively under that statute. If plaintiff was found to be partially disabled, the Commission was to make an award for both schedule injuries and nonschedule injuries that impaired wage earning power. In reference to plaintiff's claim for total disability under G.S. 97-29,³⁹⁶ the court held that the relevant inquiry in a claim for total disability is whether the particular plaintiff has a capacity to work, not whether some persons with plaintiff's degree of injury are capable of working.³⁹⁷ Because an employee's age, education and work experience may be such that an injury causes her a greater degree of incapacity than it would some other person, these "preexisting conditions" must be considered by the Industrial Commission.³⁹⁸

Plaintiff in *Little* was over fifty years of age, somewhat obese, had an eighth grade education, and had been working as a laborer earning less than two dollars per hour at the time of her injury.³⁹⁹ The court's mandate that her personal attributes be given weight in the Industrial Commission's consideration of her total disability claim is consistent with decisions in other jurisdictions,⁴⁰⁰ which uniformly reject any presumption that, merely because a claimant is physically able to do light work, appropriate employment is regularly available for her.⁴⁰¹ Because a claimant's adaptability to the situation created by her physical

If the evidence of degree of obvious physical impairment, coupled with other factors such as claimant's mental capacity, education, training, or age, places claimant *prima facie* in the odd-lot category, the burden should be on the employer to show that some kind of suitable work is regularly and continuously available to the claimant.

396. N.C. GEN. STAT. § 97-29 (Cum. Supp. 1977).

397. 295 N.C. at 531, 246 S.E.2d at 746. Although the North Carolina Supreme Court has never before mandated such an inquiry, the proposition is not altogether novel in this state. See *Mabe v. North Carolina Granite Corp.*, 15 N.C. App. 253, 189 S.E.2d 804 (1972). In *Mabe*, a case involving occupational disease rather than injury, the North Carolina Court of Appeals said that "[t]he question is what effect has the disease had upon the earning capacity of this particular plaintiff, not what effect a like physical impairment would have upon an employee of average age and intelligence." *Id.* at 255-56, 189 S.E.2d at 806. The North Carolina Court of Appeals has rejected such an inquiry, however, when all the plaintiff's injuries were encompassed in the schedule set out in § 97-31. See *Baldwin v. North Carolina Memorial Hosp.*, 32 N.C. App. 779, 233 S.E.2d 600 (1977); *Dudley v. Downtowner Motor Inn*, 13 N.C. App. 474, 186 S.E.2d 188 (1972).

398. 295 N.C. at 532, 246 S.E.2d at 746.

399. *Id.* at 531, 246 S.E.2d at 746.

400. See *Norfolk, Baltimore & Carolina Line, Inc. v. Bergeron*, 351 F. Supp. 348 (D.S.C. 1972) (62 year old claimant with third grade education, unintelligible speech, work history consisting entirely of manual labor and 63% loss of use of arm held to be totally disabled); 2 A. LARSON, *supra* note 326, § 57.51. The preexisting condition inquiry is based on the "odd-lot doctrine." Under that doctrine, "total disability may be found in the case of workers who, while not altogether incapacitated for work, are so handicapped that they will not be employed regularly in any well-known branch of the labor market." *Id.* at 10-109.

401. 2 A. LARSON, *supra* note 326, § 57.51 (1976).

injury may well be constricted by lack of education, age, and other factors, the pronouncement of the court in *Little* is eminently sensible. It also comports with the principle that claimants are entitled to have the full extent of their injury taken into consideration in awarding compensation.⁴⁰²

4. Discharge after Compensation

Under G.S. 97-6 an employer subject to the North Carolina Workmen's Compensation Act cannot relieve himself of any obligations under the Act by contract, agreement, rule, regulation or other device.⁴⁰³ The employer may not, for example, substitute an accident policy in lieu of compensation and other benefits required by the Act.⁴⁰⁴ In *Dockery v. Lampart Table Co.*,⁴⁰⁵ plaintiff argued that his discharge, after having pursued his remedies under the Act, was an attempt by his employers to create a "device" to relieve them of their obligations.⁴⁰⁶ His complaint alleged a tort theory of "retaliatory discharge," which the North Carolina Court of Appeals refused to recognize.⁴⁰⁷

The court declined to follow decisions in other jurisdictions that have allowed a cause of action in tort based on the theory of retaliatory discharge.⁴⁰⁸ It maintained that such a theory would violate the established common law contract rule that employment is terminable at the will of either party when there is no contract for a definite term.⁴⁰⁹ Although it acknowledged that the facts alleged presented valid public policy questions, the court emphasized that such questions are for the legislature.⁴¹⁰

402. *Giles v. Tri-State Erectors*, 287 N.C. 219, 214 S.E.2d 107 (1975); see 2 A. LARSON, *supra* note 326, § 57.61.

403. N.C. GEN. STAT. § 97-6 (1972).

404. *Ashe v. Barnes*, 255 N.C. 310, 121 S.E.2d 549 (1961).

405. 36 N.C. App. 293, 244 S.E.2d 272, *cert. denied*, 295 N.C. 465, 246 S.E.2d 215 (1978).

406. *Id.* at 295, 244 S.E.2d at 274.

407. *Id.* at 290-300, 244 S.E.2d at 275.

408. The Indiana Supreme Court held retaliatory discharge to be a device within the meaning of the Indiana Workmen's Compensation Act and actionable. *Frampton v. Central Ind. Gas Co.*, 260 Ind. 249, 297 N.E.2d 425 (1973). The North Carolina Court of Appeals found the reasoning of the Indiana opinion inapplicable because of the analogy that opinion drew to retaliatory eviction, which has been rejected by North Carolina courts. 36 N.C. App. at 295-96, 244 S.E.2d at 274-75 (citing *Evans v. Rose*, 12 N.C. App. 165, 182 S.E.2d 591, *cert. denied*, 279 N.C. 511, 183 S.E.2d 686 (1971)). The Texas Court of Civil Appeals decision cited by plaintiff, *Texas Steel Co. v. Douglas*, 533 S.W.2d 111 (Tex. Civ. App. 1976), was based on a statute that, unlike North Carolina's, specifically creates a cause of action in tort based on the theory of retaliatory discharge. *Id.* at 296, 244 S.E.2d at 275.

409. 36 N.C. App. at 297, 244 S.E.2d at 275.

410. *Id.* at 300, 244 S.E.2d at 277.

There was, however, a suggestion in the opinion that the court's response would have been different had this plaintiff not received his benefits pursuant to the statute,⁴¹¹ or had he alleged a pattern of activity by an employer that discouraged employees from claiming benefits under the statute.⁴¹² Had either situation prevailed the court might well have found that the employer was using a device to avoid its statutory obligations.

Since this employee did receive full compensation under the Act, the court's restraint is understandable. Because an employer who has paid benefits has not avoided its obligations, the language of G.S. 97-6 is not amenable to a construction that would hold retaliatory discharge to be a device for avoiding obligations imposed by the Act. This does not mean, however, that the facts as alleged by this plaintiff should not sustain a cause of action. Those facts, if true, not only reveal a deplorable practice, but demand legislative action to amend the statute.

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II. CIVIL PROCEDURE

A. *Jurisdiction*¹

The court of appeals decided several major cases dealing with the

411. *Id.* at 298, 244 S.E.2d at 275-76.

412. *Id.* at 299, 244 S.E.2d at 276.

1. *Pope v. Pope*, 38 N.C. App. 328, 248 S.E.2d 260 (1978), involved a suit for arrearages due under a separation agreement entered into in North Carolina. The court of appeals, holding that support payments constitute a "thing of value" within the meaning of § 4(5)(c) of North Carolina's long arm statute, N.C. GEN. STAT. § 1-75-4 (1969), rejected the nonresident defendant's challenge to its assertion of in personam jurisdiction over him. This provision allows the exercise of jurisdiction in any action that "[a]rises out of a promise, made anywhere to the plaintiff or to some third party for the plaintiff's benefit, by the defendant to deliver or receive within this State, or to ship from this State goods, documents of title, or other things of value." Although the due process question was not before the court (defendant conceded that the exercise of in personam jurisdiction would not violate the fourteenth amendment), the court of appeals in dictum indicated that parties who had resided, married and separated in North Carolina would be subject to in personam jurisdiction in any suit involving the settlement agreement, so long as one of the parties is still a resident of North Carolina. The court stated that due process requirements would

due process requirements for the assertion of jurisdiction over nonresident defendants. In *Swenson v. Thibaut*,² the court upheld an application of North Carolina's corporate director consent statute³ in the face of a *Shaffer v. Heitner*⁴ challenge. *Swenson* was a shareholders' derivative suit brought against past and present officers and directors of All American Assurance Company for breach of fiduciary duties through

be met in such a situation because the defendant has "purposefully [availed] himself of the privilege of conducting activities within the forum state, [and has invoked] the benefits and protection of its law." 38 N.C. App. at 331-32, 248 S.E.2d at 262 (citing *Goldman v. Parkland*, 277 N.C. App. 223, 229, 176 S.E.2d 784, 788 (1970)). The court also noted that under a recent United States Supreme Court decision, *Kulko v. Superior Court*, 98 S. Ct. 1690 (1978), the assertion of in personam jurisdiction over defendant was consistent with due process. 38 N.C. App. at 332, 248 S.E.2d at 262.

2. 39 N.C. App. 77, 250 S.E.2d 279 (1978).

3. N.C. GEN. STAT. § 55-33 (1975) provides for long-arm in personam jurisdiction over non-resident directors or officers of a domestic corporation. *Id.* § 1-74.4(8) defines such jurisdiction as limited to "any action against a defendant who is or was an officer or director of a domestic corporation where the action arises out of the defendant's conduct as such officer or director or out of the activities of such corporation while the defendant held office as a director or officer."

4. 433 U.S. 186 (1977). The North Carolina Court of Appeals followed this landmark United States Supreme Court decision in *Balcon, Inc. v. Sadler*, 36 N.C. App. 322, 244 S.E.2d 164 (1978), declaring N.C. GEN. STAT. § 1-75.8(4) (1975) unconstitutional on grounds that the statute, which authorized quasi in rem jurisdiction based on the attachment of property within the state, failed to meet the due process standard articulated in *Shaffer*. 36 N.C. App. at 327, 244 S.E.2d at 167. Plaintiff, a Maryland corporation not doing business in North Carolina, sought to recover from defendant, a resident of Maryland, a money judgment rendered in Maryland. Because defendant owned real property in North Carolina, plaintiff attempted to invoke the court's quasi in rem jurisdiction under § 1-75.8(4) by attaching this real property under N.C. GEN. STAT. § 1-440.1(b) (1969). The trial court granted defendant's motion to dismiss for lack of jurisdiction and the court of appeals affirmed.

Shaffer extended to in rem and quasi in rem jurisdiction the due process standard announced by the United States Supreme Court in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945): "[D]ue process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *Id.* at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)). The Court in *Shaffer* reasoned that because "[t]he phrase 'judicial jurisdiction over a thing,' is a customary elliptical way of referring to jurisdiction over the interests of persons in a thing," the same "minimum contacts" test must be applied to ensure that the exercise of jurisdiction over such interests is consistent with the due process clause. 433 U.S. at 207 (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 56, Introductory Note (1971)).

Applying *Shaffer* to the facts in *Balcon*, the court of appeals noted that "jurisdiction [can] not be based on the mere presence of property" in the forum state. 36 N.C. App. at 326, 244 S.E.2d at 167. Defendant's ownership of land in North Carolina was his only contact with the state and the controversy underlying plaintiff's claim was in no way related to that property. The court, concluding that the "minimum contacts" requirement was not met, held that jurisdiction over the case was lacking. *Id.* The court did state, however, that "[w]here real property has some relation to the controversy, the interest of the State in realty within its borders, and the defendant's substantial relationship with the forum should support jurisdiction." *Id.* Although § 1-75.8(4) was found unconstitutional, the court found § 1-75.8(5) valid despite *Shaffer*. *Id.* at 327, 244 S.E.2d at 167. This latter subsection authorizes jurisdiction in any action "in which in rem or quasi in rem jurisdiction may be constitutionally exercised." Thus quasi in rem jurisdiction remains viable in North Carolina, but only to the extent that the exercise thereof comports with the due process standards set forth in *International Shoe*.

mismanagement of company finances.⁵ Defendant⁶ moved to dismiss for lack of in personam jurisdiction. Although *Shaffer* involved the constitutionality of quasi in rem jurisdiction,⁷ defendant relied on that decision because of the substantial similarity in the facts of the two cases: both involved nonresident defendants serving as directors in domestic corporations and in both cases the directorships constituted the only real contacts between defendants and the forum states.⁸

In *Shaffer*, the United States Supreme Court had held that under these facts there were insufficient contacts to satisfy the due process test set forth in *International Shoe Co. v. Washington*.⁹ Attachment of defendants' property within the state could not provide the needed contacts because the cause of action, breach of fiduciary duties, was unrelated to the property.¹⁰ Despite its acknowledgement that the state had an important interest in regulating the affairs of domestic corporations and that the defendants as directors had been entitled to the benefits and protection of state law, the *Shaffer* Court concluded that these considerations, though relevant to choice of law, were not alone adequate for asserting jurisdiction.¹¹ In commenting on the quasi in rem jurisdictional statute involved the Court emphasized Delaware's failure to base expressly its assertion of jurisdiction on its interest in governing the activities of directors of domestic corporations.¹² The Court indicated that in the absence of such a statutory expression the director defendants were not sufficiently on notice that they would be subject to jurisdiction in the state of incorporation.¹³

Dictum in *Shaffer* thus seems to imply that the manner of wording a state's jurisdictional statute could have the effect of satisfying due process requirements under a fact situation that otherwise would fail the minimum contacts test.¹⁴ A state's articulation of its interest in as-

5. 39 N.C. App. at 82-84, 250 S.E.2d at 284-85.

6. The other directors named as defendants made a general appearance by moving to disqualify plaintiffs' attorneys and thus, said the court, waived their defense of lack of jurisdiction over the person. *Id.* at 92, 250 S.E.2d at 287.

7. See note 4 *supra*.

8. 433 U.S. at 189-92; 39 N.C. App. at 92-93, 250 S.E.2d at 290.

9. 326 U.S. 310 (1945). For the *International Shoe* test, see 326 U.S. at 316; 433 U.S. at 215-16, quoted in note 4 *supra*.

10. 433 U.S. at 213.

11. *Id.* at 215-16.

12. *Id.* at 214-15. The Court noted that "[a]lthough the sequestration procedure used here may be most frequently used in derivative suits against officers and directors . . . the authorizing statute evinces no specific concern with such actions." *Id.* at 214.

13. See *id.*; accord, 39 N.C. App. at 93, 250 S.E.2d at 290.

14. See Silberman, *Shaffer v. Heitner: The End of an Era*, 53 N.Y.U.L. Rev. 33, 65-66 (1978).

serting jurisdiction over certain individuals serves to give the required notice. Indeed, the *Shaffer* court cited G.S. 55-33¹⁵ as an example of a statute "that treats acceptance of a directorship as consent to jurisdiction in the State."¹⁶ Thus the North Carolina Court of Appeals' upholding of an application of this statute in *Swenson* was not unexpected.

The notice provided by a jurisdictional statute directed solely toward directors and officers of domestic corporations affects the fairness of making such an individual defend in the state.¹⁷ Whether the existence of such a statute should be enough to transform virtually no contacts into sufficient minimum contacts is questionable. G.S. 55-33 looks toward implied consent as a basis for assertion of jurisdiction although *International Shoe* laid such fictions to rest.¹⁸ In light of the state's obviously important interest in regulating the affairs of domestic corporations, however, it would seem that an assertion of jurisdiction pursuant to the consent statute does not "offend traditional notions of fair play and substantial justice,"¹⁹ which is the key to the due process standard.

In *Kloster v. Region D Council of Governments*,²⁰ the court of appeals considered the question whether a taxpayer has standing to challenge expenditures made by a regional council of governments.²¹ That a citizen taxpayer has standing to contest the illegal use of public money or property has long been recognized by North Carolina courts.²² *Kloster*, however, adds an interesting twist: the money to be

15. N.C. GEN. STAT. § 55-33 (1975); see 433 U.S. at 216 n.47.

16. 433 U.S. at 216.

17. See *id.* at 214.

18. See 326 U.S. at 316-17 (1945).

19. *International Shoe Co. v. Washington*, 326 U.S. at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)). In applying the minimum contacts test the court of appeals relied on *Byham v. National Cibo House Corp.*, 265 N.C. 50, 143 S.E.2d 225 (1965), noting that the following factors should be considered: whether defendant "purposefully avails itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protection of its laws," 39 N.C. App. at 94, 250 S.E.2d at 290; whether the case involves some legitimate interest of the forum state "in protecting its residents with respect to the activities and contacts of the nonresident," *id.* (this factor may have had special weight in *Swenson*, since the corporation involved was an insurance company, see *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957)); the relative convenience of the forum to both plaintiff and defendant, 39 N.C. App. at 94, 250 S.E.2d at 290; and "the extent to which the legislature of the forum state has given authority to its courts to entertain litigation against non-residents," *id.* at 93-97, 250 S.E.2d at 290-92.

20. 36 N.C. App. 421, 245 S.E.2d 180, cert. denied, 295 N.C. 466, 246 S.E.2d 215 (1978).

21. N.C. GEN. STAT. § 160A-470 (1976) authorizes the creation of regional councils of government by concurrent resolution of any two or more units of local government (county, city, or consolidated city-county).

22. See *Shaw v. Asheville*, 269 N.C. 90, 152 S.E.2d 139 (1967); *Wishart v. Lumberton*, 254

used by defendant came not from local taxes but from a federal grant.²³ Although noting decisions to the contrary,²⁴ the court of appeals followed the reasoning in *Shipley v. Smith*²⁵ and held that a taxpayer's interest in the use of public funds is sufficient to confer standing regardless of their source.²⁶ The court rejected an argument by defendant that, because it is not a taxing authority, it should not be treated as a municipality subject to suit by taxpayers.²⁷ In holding that the taxpayer here did have standing to contest the use of public funds by the council, the court indicated that standing would arise not only in situations involving the use of local or federal money or property, but also in situations involving "activities [which] may later require support by tax monies."²⁸ This latter pronouncement would seem to extend taxpayer standing to include challenges to almost every conceivable activity of state and local governmental units.

B. Notice and Service of Process

In *Wiles v. Welparnel Construction Co.*,²⁹ the North Carolina Supreme Court, overruling prior case law, held that service of a summons directed to a person designated as the agent of a corporation is sufficient service of process on the corporation so long as the corporation is named as the defendant in both the complaint and the caption of the summons.³⁰ In reaching its decision the court reinterpreted the re-

N.C. 94, 118 S.E.2d 35 (1961); *Merrimon v. Southern Paving & Constr. Co.*, 142 N.C. 539, 55 S.E. 366 (1906).

23. The funds were provided by the Economic Development Administration of the U.S. Department of Commerce. 36 N.C. App. at 422, 245 S.E.2d at 181.

24. *Id.* at 425, 245 S.E.2d at 183; *see, e.g., Andrews v. City of South Haven*, 187 Mich. 294, 153 N.W. 827 (1915) (taxpayers lack standing to enjoin activities totally funded with nontax or donative funds).

25. 45 N.M. 23, 107 P.2d 1050 (1940). The New Mexico court held that a taxpayer had standing to seek an order restraining the use of public funds although the money was received as a donation rather than through taxation. Comparing the taxpayer to a shareholder in a private corporation, the court noted that just as corporate directors have no more right to waste money received by the corporation as a gift than to waste money paid in by shareholders through stock purchases, a municipality cannot waste public funds regardless of their origin.

26. 36 N.C. App. at 426, 245 S.E.2d at 183.

27. *Id.* Noting that councils of government are set up to coordinate governmental functions best undertaken on a regional level, the court stated: "[We] do not believe that the General Assembly, in establishing the framework for such councils, intended that it would be a means by which local governmental functions would be isolated from local taxpayer suits designed to contest the legality of council action." *Id.* at 427, 245 S.E.2d at 184.

28. *Id.* at 427, 245 S.E.2d at 184.

29. 295 N.C. 81, 243 S.E.2d 756 (1978).

30. In so holding, the court expressly overruled a line of cases represented by *Russell v. Bea Staple Mfg. Co.*, 266 N.C. 531, 146 S.E.2d 459 (1966); *Hassell & Co. v. Daniels' Roanoke River Line Steamboat Co.*, 168 N.C. 296, 84 S.E. 363 (1915); *Plemmons v. Southern Improvement Co.*,

quirements of North Carolina Rule of Civil Procedure 4(b),³¹ which provides that the name appearing in the directory paragraph of the summons should be that of the defendant rather than that of a process officer being ordered to summon the defendant. Up to this point North Carolina case law strictly required that the summons be directed to the defendant; a summons directed to an individual described as an agent or officer of the defendant was fatally defective.³² Examining the rationale behind requirements regarding sufficiency of process, the court noted that rule 4 of the Federal Rules of Civil Procedure,³³ which is similar to North Carolina's rule, is intended "to provide the mechanisms for bringing notice of the commencement of an action to defendant's attention and to provide a ritual that marks the court's assertion of jurisdiction over the lawsuit."³⁴ The court, after considering the summons before it on appeal³⁵ in light of this purpose of giving notice to defendant, found that the naming of the corporation as defendant in both the caption of the summons and the accompanying complaint³⁶ eliminated any confusion that might arise from the agent being named in the directory paragraph, thus giving defendant adequate notice.³⁷

Although a literal application of rule 4(b) would require finding the summons in question insufficient, the court was willing to look beyond the language of the rule to its purpose of providing notice. This more realistic approach indicates an increased willingness on the part of the court to apply the Rules of Civil Procedure, not as stumbling blocks in the path of an unwary party,³⁸ but as a means of facilitating litigation on the merits.

The court of appeals in *Great Dane Trailers, Inc. v. North Brook*

108 N.C. 614, 13 S.E. 188 (1891); and *Carl Rose & Sons Ready Mix Concrete, Inc. v. Thorpe Sales Corp.*, 30 N.C. App. 526, 227 S.E. 2d 301 (1976). These cases held that a court lacks jurisdiction over the person if the summons is not *directed* to the defendant.

31. N.C.R. Civ. P. 4(b).

32. 295 N.C. at 83, 243 S.E.2d at 757; *see, e.g.*, *Carl Rose & Sons Ready Mix Concrete, Inc. v. Thorpe Sales Corp.*, 30 N.C. App. 526, 227 S.E.2d 301 (1976).

33. FED. R. CIV. P. 4.

34. 295 N.C. at 84, 243 S.E.2d at 758 (quoting 4 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 1063 (1969)).

35. The summons was directed to "Mr. T.T. Nelson, Registered Agent/Welparnel Construction Company, Inc./ [address]." *Id.* at 82, 243 S.E.2d at 756.

36. N.C.R. Civ. P. 4 requires that the summons and complaint be served together.

37. 295 N.C. at 85, 243 S.E.2d at 758; *see* 4 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 1088 (1969).

38. If the court had found the summons defective plaintiff would have lost forever his opportunity to bring suit, because defendant then would not have been subjected to in personam jurisdiction before the running of the statute of limitations. *See* 295 N.C. at 82, 243 S.E.2d at 757.

*Poultry, Inc.*³⁹ held that a corporate defendant was properly served with process when copies of the summons and complaint were left at the home and with the wife of its registered agent. Under rule 4(j)(6)(b) process may be served upon a corporation "[b]y delivering a copy of the summons and of the complaint to an agent authorized by appointment or by law to be served or to accept service of process or by serving process upon such agent or the party in a manner specified by any statute."⁴⁰ Since a registered agent for a corporation may thus be served in the same manner as an individual, service of process may be made pursuant to rule 4(j)(1)(a),⁴¹ which permits service by leaving copies of the summons and complaint at an individual's home with a person of suitable age and discretion. Although the result in *Great Dane Trailers* was clear under the statutes involved, it is noteworthy because it calls attention to the difference between rule 4(j)(6)(b) and its federal counterpart. Under federal rule 4(d)(7) service may be made on a corporation "in the manner prescribed by any statute of the United States."⁴² The courts have interpreted this rule as referring only to those statutes providing for service on corporations;⁴³ because service on a registered agent is thus not available pursuant to rule 4(d)(1),⁴⁴ the federal rules would not support service of process in the manner approved in *Great Dane Trailers*. Parties bringing suit in North Carolina against corporate defendants thus can make use of an alternative means of serving process not available to those using the federal forum.

39. 35 N.C. App. 752, 242 S.E.2d 533 (1978).

40. N.C.R. Civ. P. 4(j)(6)(b).

41. *Id.* 4(j)(1)(a).

42. FED. R. CIV. P. 4(d)(7). In the North Carolina rule the words "in any manner specified by any statute" refer to service on the agent of the corporation, as well as service on the corporation itself.

43. See *Tyson v. Publishers Co.*, 223 F. Supp. 114 (E.D. Pa. 1963); *Bard v. Bemidji Bottle Gas Co.*, 23 F.R.D. 299 (D. Minn. 1958); *in re Eizen Furs, Inc.*, 10 F.R.D. 137 (E.D. Pa. 1950).

44. FED. R. CIV. P. 4(d)(1). This subdivision provides for service upon an individual "by delivering a copy of the summons and of the complaint to him personally or by leaving copies thereof at his dwelling house or usual place of abode with some person of suitable age and discretion residing therein."

*C. Amendments*⁴⁵

In *Gro-Mar Public Relations, Inc. v. Billy Jack Enterprises, Inc.*,⁴⁶ the court of appeals found an abuse of discretion in the trial court's denial of plaintiff's motion to amend its complaint to show jurisdictional grounds. Defendant had moved to dismiss for lack of jurisdiction over the person;⁴⁷ after holding a hearing the court granted the motion and instructed defendant's attorney to submit an order to that effect. The following day plaintiff moved under rule 15(a)⁴⁸ to amend its complaint to allege that it and defendant were parties to a contract to be performed in North Carolina.⁴⁹ The trial court denied plaintiff's motion and signed the order submitted by defendant granting its motion to dismiss. From the denial of its motion, plaintiff appealed.⁵⁰

The court of appeals held that under rule 15(a)⁵¹ the trial court should have granted plaintiff's motion to amend its complaint. Support for this conclusion was found in *Vernon v. Crist*,⁵² in which the North Carolina Supreme Court noted that "leave to amend should be 'freely given when justice so requires' and that the burden is on the party objecting to the amendment to show that he would be prejudiced

45. In *Turner Halsey Co. v. Lawrence Knitting Mills, Inc.*, 38 N.C. App. 569, 248 S.E.2d 342 (1978), the court of appeals held that the trial court erred in granting plaintiff's motion for summary judgment on the same day it granted plaintiff's motion to amend its complaint. N.C.R. Civ. P. 15(a) provides that "a party shall plead in response to an amended pleading . . . , unless the court otherwise orders." The court of appeals interpreted the rule to require that defendants be given an opportunity to answer before the court hears plaintiff's motion for summary judgment. 38 N.C. App. at 572-73, 248 S.E.2d at 345. N.C.R. Civ. P. 56(c) provides that summary judgment shall be granted "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." If in amending its complaint a party makes some material alteration to its previous contentions the trial court cannot know before the other party has answered whether this alteration has given rise to a genuine issue about any material fact. Thus it seems that a simultaneous grant of leave to amend a complaint and summary judgment will be improper if the amendment is one that could give rise to a genuine issue about any material fact.

46. 36 N.C. App. 673, 245 S.E.2d 782 (1978).

47. *Id.* at 675, 245 S.E.2d at 783. Defendant also based his motion to dismiss on alleged insufficiency of summons and service of process. The court of appeals, following the decision in *Wiles*, found both summons and service of process sufficient. *Id.* at 675-76, 245 S.E.2d at 784.

48. N.C.R. Civ. P. 15(a).

49. N.C. GEN. STAT. § 55-145(a)(1) (1975) provides that a foreign corporation is subject to suit in North Carolina on any cause of action arising "[o]ut of any contract made in this State or to be performed in this State," regardless of whether the corporation has ever transacted business in the state. Defendant in this case was a foreign corporation. 36 N.C. App. at 674, 245 S.E.2d at 783.

50. 36 N.C. App. at 675, 245 S.E.2d at 783.

51. Under N.C.R. Civ. P. 15(a), when amendment is not allowed as a matter of course, "a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires."

52. 291 N.C. 646, 231 S.E.2d 591 (1977).

thereby.”⁵³ In addition the court relied on *Foman v. Davis*,⁵⁴ a United States Supreme Court decision that mandated granting leave to amend, subject to certain exceptions, and warned that a denial of leave to amend without justification would constitute an abuse of discretion.⁵⁵

There are several problems with the court's analysis in *Gro-Mar*. In the first place, the North Carolina rules do not require that grounds for jurisdiction be set forth in the complaint.⁵⁶ If an amendment is superfluous, it is difficult to understand how denial of the amendment could constitute an abuse of discretion. Second, plaintiff had an opportunity to present arguments in favor of a finding of jurisdiction at the hearing on defendant's motion to dismiss. In considering how to rule on defendant's motion, the trial court must have weighed any grounds plaintiff had put forth in support of in personam jurisdiction. Thus the trial court's grant of defendant's motion indicated a finding that grounds for jurisdiction were lacking. Consequently, its denial of leave to amend to allege grounds for jurisdiction could hardly be considered an abuse of discretion.

The *Gro-Mar* court's endorsement of *Foman v. Davis* has far-reaching implications. Language in *Foman* indicates that a court abuses its discretion if it denies leave to amend without specifically setting forth its grounds for denial, unless the reasons for denial are otherwise apparent.⁵⁷ Thus, in *Gro-Mar* the court pointed out that “the trial court failed to state a reason [for denying leave to amend]” and added “nor do we perceive that there are any ‘apparent’ reasons for denial of leave to amend.”⁵⁸ Although it would seem that reasons for denial were clear in this case, the court's use of *Foman* indicates that in future cases a court's failure to specifically set forth its rationale in denying leave to amend may constitute an abuse of discretion.

53. *Id.* at 654, 231 S.E.2d at 596. Defendant had made no such showing.

54. 371 U.S. 178 (1962). FED. R. CIV. P. 15(a) is almost identical to North Carolina's rule.

55. 371 U.S. at 182. In the language of the Court:

In the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as the rules require, be “freely given.” Of course, the grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules.

Id.

56. N.C.R. Civ. P. 8.

57. See note 55 *supra*.

58. 36 N.C. App. at 679, 245 S.E.2d at 785.

A denial of leave to amend a complaint to add a party defendant worked a harsh result upon the plaintiff in *Callicutt v. American Honda Motor Co.*⁵⁹ Plaintiff had brought suit against American Honda Motor Company to recover for injuries sustained as a result of alleged negligence and breach of warranty. In its answer defendant admitted manufacturing and selling the motorcycle involved but denied negligence and breach of warranty.⁶⁰ After the statute of limitations had run defendant sought leave to amend its answer, asserting that it had recently become aware that Honda Motor Company, Ltd. was the actual manufacturer of the motorcycle. The trial court granted defendant's motion. Shortly thereafter plaintiff moved to amend its complaint to add Honda Motor Company, Ltd. as a party defendant. The motion was denied, and plaintiff appealed.⁶¹

The court of appeals found no abuse of discretion in the trial court's denial of leave to amend. Noting that *Foman v. Davis* acknowledged futility of amendment as sufficient justification for denying leave to amend, the court considered whether the proposed amendment would relate back; if relation back were precluded, the statute of limitations would be a complete defense to a suit by plaintiff against Honda Motor Company, Ltd., thus rendering amendment futile. The court held that under rule 15(c)⁶² relation back could not be had because the original complaint did not give notice to Honda Motor Company, Ltd.⁶³

Although the court of appeals concluded that the record contained nothing indicating any relationship between the two motor companies,

59. 37 N.C. App. 210, 245 S.E.2d 558 (1978).

60. *Id.* Partial summary judgment for defendant was subsequently granted on the breach of warranty claim. *Id.*

61. *Id.* at 210-11, 245 S.E.2d at 559.

62. N.C.R. Civ. P. 15(c):

A claim asserted in an amended pleading is deemed to have been interposed at the time the claim in the original pleading was interposed, unless the original pleading does not give notice of the transactions, occurrences, or series of transactions or occurrences, to be proved pursuant to the amended pleading.

Although the language of this rule is arguably not applicable to amendments adding new parties, the court of appeals relied on *Teague v. Asheboro Motor Co.*, 14 N.C. App. 736, 189 S.E.2d 671 (1972), which interpreted 15(c) to require "that the claim asserted in the amendment must be against one given notice in the original pleading of the transactions to be proved." *Id.* at 739, 189 S.E.2d at 673; *cf.* FED. R. CIV. P. 15(c) (provides for relation back of amendment changing a party if claim asserted arose out of same conduct, transaction, or occurrence set forth in original pleading and if new party "(1) has received such notice [before the running of the statute of limitations] of the institution of the action that he will not be prejudiced in maintaining his defense on the merits, and (2) knew or should have known that, but for a mistake concerning the identity of the proper party, the action would have been brought against him").

63. 37 N.C. App. at 211-13, 245 S.E.2d at 560.

arguably judicial notice could have been taken of what would seem a possible parent/subsidiary or manufacturer/distributor arrangement.⁶⁴ Alternatively, the court could have held American Honda Motor Company, Inc. to be equitably estopped from denying that it manufactured the car, since information relating to manufacture was solely within its knowledge and its timing in releasing this information worked to deprive plaintiff of a substantial part of his cause of action.⁶⁵ The court's failure to look beyond a technical application of procedural rules led to this unnecessarily harsh result.

D. Local Rules

Rule 40 of the North Carolina Rules of Civil Procedure provides that the senior resident superior court judge of each judicial district "may provide by rule for the calendaring of actions for trial in the superior court."⁶⁶ Once a local rule is promulgated the question arises whether the court has discretion to deviate from its provisions. This issue was addressed, at least obliquely, by the North Carolina Court of Appeals in *Forman & Zuckerman v. Schupak*.⁶⁷ Plaintiff, after the non-appearance of defendants in an action for unpaid legal fees, filed a motion for judgment by default together with a request that the motion be calendared for hearing.⁶⁸ Defendants responded by letter to the calendaring clerk indicating that the request for hearing was one day late under local rules and therefore could not be considered.⁶⁹ Plaintiff then wrote the calendaring clerk, forwarding a copy to defendants, indicating that the hearing appeared on the final calendar on the date requested.⁷⁰ When the hearing was held as scheduled and defendants did not appear, the judge entered judgment by default against them.⁷¹

64. If such a relationship were found to exist, it could provide not only a potential basis for liability of Honda Motor Company, Ltd., see Annot., 7 A.L.R.3d 1343 (1966), but could also be indicative of whether Honda Motor Company, Ltd. was put on notice through American Honda Motor Company.

65. Cf. *Zielinski v. Philadelphia Piers, Inc.*, 139 F. Supp. 408 (E.D. Pa. 1956) (defendant made inaccurate answer which it knew, or had within its control the means of knowing, was inaccurate; held: defendant estopped from taking advantage of statute of limitations when its conduct has thus misled plaintiff).

66. N.C.R. Civ. P. 40(a).

67. 38 N.C. App. 17, 247 S.E.2d 266 (1978).

68. *Id.* at 18, 247 S.E.2d at 268.

69. *Id.* The request was made 13 days prior to the requested hearing date. The local rule provided that "[r]equests for pretrial hearings on motions will be considered by the Calendar Committee if filed by 5:00 p.m. on Monday two (2) weeks prior to the beginning of the session requested." *Id.* at 21, 247 S.E.2d at 269.

70. *Id.* at 18, 247 S.E.2d at 268.

71. *Id.* at 18-19, 247 S.E.2d at 268.

On appeal defendants argued that the court erred by calendaring plaintiff's motion in violation of local rules.⁷² In its opinion, the court of appeals interpreted the local rule not to *prohibit* the calendaring of a motion if the request is late, but merely to allow the calendar committee not to consider late requests if it so chooses.⁷³ The court also intimated, however, that even if the rule does prohibit calendaring of a hearing if the request is tardy, the trial court has wide discretion to decide whether to apply local rules in any given instance.⁷⁴ The court indicated that the two considerations in the trial judge's exercise of this discretion are actual harm to the complaining party and efficient court administration.⁷⁵ Thus, under the court's opinion a trial judge can choose to ignore a local rule if the complaining party is not harmed and if the efficient administration of the court is not impeded.⁷⁶

This view of the force of local rules is not shared by the federal courts. Their view is that although a trial judge can interpret an ambiguous rule, he cannot refuse to apply an applicable rule simply because the complaining party was not harmed nor court efficiency impeded.

72. *Id.* at 20, 247 S.E.2d at 269. Defendants also argued that failure to abide by the local rule denied them due process. *Id.* at 19, 247 S.E.2d at 268. The court of appeals rejected this argument because defendants had actual notice of the hearing. *Id.*

73. *Id.* at 21, 247 S.E.2d at 269. It is equally plausible to read the language of the rule as prohibiting the calendaring of a motion on late request. *See* note 69 *supra*. When the language of a local rule is ambiguous, as it was in this case, the promulgating court is usually the best source of interpretation. *See* 12 C. WRIGHT & A. MILLER, *supra* note 37, § 3153 (1973). The trial court in this case, however, did not have the opportunity to interpret the local rule involved because defendant was defaulted for failure to appear and hence was not present to argue its interpretation of the local rule. Thus, in absence of a trial court's interpretation of its own rule, the court of appeals should be a proper interpreter. Moreover, under North Carolina's rule 40 local calendaring rules are promulgated, not by a majority vote of the local judges as in federal courts, Fed. R. Civ. P. 83, but by the senior resident superior court judge acting alone. Thus, it can be argued that even if there is a trial court interpretation by a nonpromulgating judge, the appellate court is at least as proper an interpreter as that judge. For this reason it is arguable that the court of appeals need not give as much deference to an interpretation by a lower court as do the federal courts.

74. 38 N.C. App. at 21, 247 S.E.2d at 269.

75. *Id.* at 20-21, 247 S.E.2d at 269. The conclusion that judges have discretion to avoid local rules in the interest of efficient court administration is clearly implied in the court's attempt to distinguish the administrative law rule that requires government agencies to follow their self-promulgated procedures even though the procedures did not originally arise from any constitutional requirement. *See id.* The court reasoned that administrative rules, unlike local court rules, "generally take on certain aspects of both procedural and substantive law," while local rules of court are adopted solely to promote effective administration of justice. *Id.* at 20, 247 S.E.2d at 269. The court does stop short of saying that local rules are only concerned with court administration by finding that the defendants in this case were in no way harmed by the calendaring of the motion despite the late request. *Id.* at 21, 247 S.E.2d at 269. This inquiry into harm indicates that not only court efficiency but also the procedural and reliance interests of the parties are considerations in the trial court's exercise of discretion.

76. The court of appeals' interpretation that the language of the local rule did not prohibit the calendaring of late requests was sufficient to dispose of the case. Therefore, the court's further discussion of the trial court's discretion to apply local rules is dictum.

"Because local rules do have the force of law, they should be held to be binding upon parties and upon the court that promulgated them"⁷⁷ This principle has special application in North Carolina because a single judge should not have the power to refuse to apply a rule promulgated by his senior superior court judge pursuant to specific legislative authority. Thus, while the trial court and the appellate courts have authority to interpret the language of local rules, any suggestion in the court's opinion in *Schupak* that the trial court has discretion in its application of an unambiguous rule should be ignored.

E. Dismissal of Actions—Rule 41

North Carolina Rule of Civil Procedure 41(a)(1) provides that a plaintiff can dismiss his own action at any time before resting his case without having the dismissal operate as an adjudication on the merits.⁷⁸ If plaintiff has already rested his case, a dismissal without prejudice can be obtained only by order of the judge pursuant to rule 41(a)(2).⁷⁹ Rule 41(a)(2), therefore, is often invoked to avoid adjudication on the merits

77. 12 C. WRIGHT & A. MILLER, *supra* note 37, § 3153. See also *Woods Constr. Co. v. Atlas Chem. Indus., Inc.*, 337 F.2d 888 (10th Cir. 1964). But see *Frankel v. Alan Wood Steel Co.*, 31 F.R.D. 284 (E.D. Pa. 1962).

78. N.C.R. Civ. P. 41(a)(1). Rule 41(d), however, formerly required that a plaintiff, having taken a voluntary dismissal under 41(a)(1), pay defendant's costs in the action previously dismissed before bringing a second suit on the same claim. The court was required, upon motion of the defendant, to dismiss the second suit if brought before those costs were paid. N.C.R. Civ. P. 41(d), N.C. GEN. STAT. § 1A-1 (1969); see *Thigpen v. Piver*, 37 N.C. App. 382, 246 S.E.2d 67, *cert. denied*, 295 N.C. 653, 248 S.E.2d 257 (1978). Effective January 1, 1978, this rule has been changed. Law of May 2, 1977, ch. 290, 1977 N.C. Sess. Laws 296. No longer is the court immediately required to dismiss the nonpaying plaintiff's second suit, but

the court, upon motion of the defendant, shall make an order for the payment of such costs by the plaintiff within 30 days and shall stay the proceedings in the action until the plaintiff has complied with the order. If the plaintiff does not comply with the order, the court shall dismiss the action.

N.C.R. Civ. P. 41(d). This new provision is still quite different from the federal rule, which gives a federal court discretion to decide whether to require payment of costs. FED. R. Civ. P. 41(d). This discretion is necessary in federal court because, unlike the North Carolina rule 41(d), the federal rule provides no exception for plaintiffs who are financially unable. Because North Carolina has such an exception it is not necessary to give state judges the discretion enjoyed by their federal counterparts. The old North Carolina rule, however, was too harsh in requiring immediate dismissal of the second action for failure to pay the costs, because many times there may have been good reason beyond plaintiffs' control that forced taking a voluntary dismissal. See 9 C. WRIGHT & A. MILLER, *supra* note 37, § 2375 n.41. Thus, the North Carolina version of rule 41(d) now requires the payment of costs without being overly harsh to either the indigent plaintiff or the plaintiff who had good reason to take a voluntary dismissal. Furthermore, the nondiscretionary nature of North Carolina rule 41(d) provides a stronger discouragement to plaintiff's considering a 41(a)(1) voluntary dismissal than does the federal version. Such a disincentive is needed because in contrast to federal rule 41(a)(1), which permits a voluntary dismissal to be taken only up to service of an answer or motion for summary judgment, North Carolina rule 41(a) allows such a dismissal anytime before plaintiff rests his case.

79. N.C.R. Civ. P. 41(a)(2).

when the trial judge has intimated an intention to grant an adverse directed verdict or judgment notwithstanding the verdict.⁸⁰ A plaintiff who dismisses pursuant to rule 41(a)(1) or (2) is allowed an additional year in which to refile.⁸¹ As illustrated in *West v. Reddick, Inc.*,⁸² a rule 41(a)(2) motion can be made after a previous dismissal to convert that previous dismissal into one under rule 41(a)(2), thus allowing the additional time to refile. The *West* court, however, failed to recognize that to effect such a result the 41(a)(2) motion must be made within ten days of the previous dismissal.

Plaintiff in *West* commenced a personal injury action within the limitation period.⁸³ Defendant then moved for and received a dismissal of plaintiff's claim for lack of personal jurisdiction.⁸⁴ Such a dismissal is normally without prejudice,⁸⁵ but in this case, the statute of limitations had expired between the time plaintiff filed his complaint and the time of the dismissal for lack of personal jurisdiction.⁸⁶ Plaintiff could have preempted the impending dismissal for lack of personal jurisdiction by taking a voluntary dismissal under rule 41(a)(1), which would have given him an additional year in which to bring another suit.⁸⁷ After the dismissal for lack of jurisdiction, however, plaintiff could no longer take a voluntary dismissal under 41(a)(1).⁸⁸ Alternatively, had plaintiff asked the court *at the time* of the dismissal for a

80. W. SHUFORD, NORTH CAROLINA CIVIL PRACTICE AND PROCEDURE § 41-5 (1975 & Supp. 1978).

81. N.C.R. Civ. P. 41(a). If the 41(a) dismissal is pursuant to a stipulation by all the parties or to an order of the court the stipulation or order can specify an amount of time shorter than one year in which to refile the claim.

82. 38 N.C. App. 370, 248 S.E.2d 112 (1978).

83. *See id.*

84. *Id.* at 370, 248 S.E.2d at 113.

85. N.C.R. Civ. P. 41(b) states: "Unless the court in its order for dismissal otherwise specifies, . . . any dismissal . . . , other than a dismissal for lack of jurisdiction . . . , operates as an adjudication upon the merits."

86. Although the opinion does not mention that the statute had run, from the dates given it appears that although the complaint was filed in time, the statute had expired before the dismissal for lack of jurisdiction. A three year limitation period is applicable for personal injury due to negligence. N.C. GEN. STAT. § 1-52(5) (Cum. Supp. 1977); *see Sheppard v. Barrus Constr. Co.*, 11 N.C. App. 358, 181 S.E.2d 130 (1971). The injury occurred July 25, 1974, the complaint was filed July 22, 1976, and the dismissal for lack of jurisdiction occurred September 12, 1977.

87. *See* N.C.R. Civ. P. 41(a)(1). The one year extension is available under rule 41(a)(1) even though the court is later found to have lacked personal jurisdiction. "If an action commenced within the time prescribed therefor . . . is dismissed without prejudice under this subsection, a new action based on the same claim may be commenced within one year after such dismissal" *Id.* (emphasis added). "A civil action is commenced by filing a complaint with the court." N.C.R. Civ. P. 3 (emphasis added). Thus, it is clear that it is the filing of a complaint and not the obtaining of personal jurisdiction through a valid summons that is the prerequisite to a 41(a)(1) dismissal and the additional year in which to refile provided thereunder.

88. *See* Wood v. Wood, 37 N.C. App. 570, 246 S.E.2d 549 (1978).

voluntary dismissal under 41(a)(2), the court could have granted his motion, allowing him an additional year in which to refile his claim.⁸⁹ Plaintiff did in fact move for a 41(a)(2) voluntary dismissal, but not until three days *after* being dismissed for lack of jurisdiction. Nonetheless, the trial judge granted the motion.⁹⁰

On appeal, defendant argued that it is incongruous to allow a trial judge to dismiss a case a second time after he has already dismissed it once.⁹¹ The court of appeals curtly dismissed this argument by saying, "Rule 41 places no time limit on the right of a plaintiff to move for a voluntary dismissal under 41(a)(2)."⁹² Taking this reasoning to its extreme reveals its shortcomings: if there is no time limit on when a dismissed plaintiff may ask the court to grant a dismissal pursuant to rule 41(a)(2), which allows him an additional year to bring suit, the defendant in such a situation will *never* be secure from suit on the claim despite the running of the statute of limitations. Although it does not seem unreasonable for a plaintiff to ask the trial judge three days after being dismissed to convert his dismissal into one pursuant to rule 41(a)(2), thus avoiding any statute of limitations bar to another suit, there must be a time limit on such a request.

To set a limit on this practice, perhaps a motion by a plaintiff for a 41(a)(2) voluntary dismissal made after already having been dismissed for another reason should be viewed as a motion to convert the first dismissal into one pursuant to 41(a)(2).⁹³ Under this approach the year extension of time in which to bring a second suit would begin to run, not at the time of the 41(a)(2) motion, but at the time of the original dismissal. Therefore, a 41(a)(2) motion made more than one year after a previous dismissal would be of no avail in extending the time in which to bring a second suit.

There is, however, an even more restrictive time limit that should

89. See N.C.R. Civ. P. 41(a)(2). Unlike a voluntary dismissal under 41(a)(1) the judge must take affirmative action to grant a 41(a)(2) dismissal. In view of this distinction it can be argued that while personal jurisdiction is not a prerequisite for a 41(a)(1) dismissal, *see* note 87 *supra*, it is for a 41(a)(2) dismissal. Rule 41(a)(2), however, like rule 41(a)(1) appears to condition the additional year in which to refile only on commencement of the first suit within the statute of limitations. Because filing of a complaint constitutes commencement of a suit, it would appear that failure to obtain personal jurisdiction would not preclude the judge's granting a 41(a)(2) dismissal.

90. 38 N.C. App. at 371, 248 S.E.2d at 113.

91. See also *Wood v. Wood*, 37 N.C. App. 570, 246 S.E.2d 549 (1978).

92. 38 N.C. App. at 372, 248 S.E.2d at 113.

93. See *Wood v. Wood*, 37 N.C. App. 570, 246 S.E.2d 549 (1978). "Obviously, a voluntary dismissal under Rule 41 will lie only prior to entry of final judgment. After final judgment, any correction, modification, amendment, or setting aside can only be done by the court." *Id.* at 575, 246 S.E.2d at 552.

be applicable to a motion for a 41(a)(2) voluntary dismissal made after a previous dismissal. Rule 59(e) provides that "[a] motion to alter or amend the judgment . . . shall be served not later than 10 days after entry of the judgment."⁹⁴ It is clear that rule 59(e) can be invoked to alter or amend not only a judgment on the merits but an order terminating an action prior to any trial, although not an adjudication on the merits.⁹⁵ Thus, a motion under rule 59(e) would have been appropriate in *West* when plaintiff sought to convert dismissal for lack of personal jurisdiction into a 41(a)(2) dismissal and thereby gain additional time to refile his claim.⁹⁶ Therefore, the court of appeals was correct in affirming the trial judge's allowance of plaintiff's 41(a)(2) dismissal, not because such motions can be made "at any time," but because it was made within the ten day limit of rule 59(e).⁹⁷

94. N.C.R. Civ. P. 59(e).

95. In *Graddy v. Bonsal*, 375 F.2d 764, 765 (2d Cir. 1967), plaintiff's motion to vacate an earlier dismissal for lack of federal jurisdiction was regarded as a motion "to alter or amend the judgment" under Fed. R. Civ. P. 59(e)." In *Silk v. Sandoval*, 435 F.2d 1266 (1st Cir. 1971), plaintiff's motion to vacate an earlier dismissal for nonjoinder, which like a dismissal for lack of jurisdiction is not an adjudication on the merits, was also subject to the 10 day limit under rule 59(e). See also 6A MOORE'S FEDERAL PRACTICE ¶ 59.12[1], at 59-247 (2d ed. 1974) ("Relief may be sought under Rule 59(e) on a timely motion to amend the judgment to alter the dismissal from one without prejudice to a dismissal with prejudice, and vice versa . . ."); W. SHUFORD, *supra* note 80, ¶ 59-18 ("This section will be applicable in situations where . . . relief is sought from an order terminating the action prior to trial."). But see *Myers v. Westland Oil Co.*, 96 F. Supp. 667 (D.N.D. 1949). In *Myers* plaintiff was dismissed for lack of jurisdiction. The court granted plaintiff's motion to add the words "without prejudice" to the dismissal although the motion was made six months after the dismissal. Professor Moore calls this result "clearly untenable" because the motion should not have been granted unless made within the 10 day limit of rule 59(e). 6A MOORE'S FEDERAL PRACTICE, *supra*, ¶ 59.12[1], at 59-244 n.17.

96. If plaintiff does not make the 10 day time limit he might attempt to argue that the motion to alter the dismissal is a motion for rule 60(b)(1) relief on the grounds of mistake or excusable neglect. Plaintiff can attempt to show an excuse for not asking for a 41(b)(2) at the time of the original motion or within 10 days thereafter. Alternatively, he can argue that the court made a mistake by not dismissing pursuant to 41(b)(2). Any attempt, however, to utilize 60(b) to avoid the 10 day time limit of rule 59(e) should be a last resort. See *Silk v. Sandoval*, 435 F.2d 1266 (1st Cir. 1971) (court refused to give broad interpretation to rule 60(b)(1) and permit avoidance of rule 59(e)'s 10 day time limit).

97. The court's reliance on *King v. Lee*, 279 N.C. 100, 181 S.E.2d 400 (1971), for the "no time limit" idea is inapposite. In *King* the supreme court remanded the case to the trial court to permit a motion for a voluntary dismissal. This holding, which dealt with a case on appeal that was remanded to the trial court, cannot support the idea that once an action leaves the trial court on a final ruling the losing party can, without appealing, ask the trial court for a 41(a)(2) voluntary dismissal at any time in the future.

Fifteen days after the trial judge in *West* granted plaintiff's 41(a)(2) voluntary dismissal the judge entered a supplemental order stating that the previously allowed motion to dismiss for lack of jurisdiction was a mistake, and therefore void, and that the order granting plaintiff's 41(a)(2) was what he actually intended. 38 N.C. App. at 371, 248 S.E.2d at 113. The court of appeals held that this supplemental order "is of no effect" because (1) when the supplemental order was entered defendant had already filed an appeal of the previous order allowing the 41(a)(2) dismissal and (2) the term of court had expired. *Id.* at 372, 248 S.E.2d at 114. The rule that a party cannot seek to amend a judgment after the expiration of the term of court is old law and has been supplanted by

F. Appeal and Error⁹⁸

In North Carolina there are two ways to take an appeal from an order determining less than all the claims for relief in an action. Such an appeal lies if the trial judge certifies the appeal by entering a final judgment on one or more but fewer than all of the claims pursuant to his authority under rule 54(b).⁹⁹ An appeal is also allowed under G.S. 1-277 or 7A-27 without the trial judge's certification¹⁰⁰ if the interlocutory order "affects a substantial right."¹⁰¹ Justice Exum in *Waters v. Qualified Personnel, Inc.*¹⁰² admitted that this "'substantial right' test for appealability of interlocutory orders is more easily stated than applied."¹⁰³ Yet an examination of that case in comparison with a previous supreme court case on the issue of appealability suggests a general proposition that in many circumstances should be helpful in analyzing the substantial right issue: the right to avoid one trial on the disputed issues is not normally a substantial right that would allow an interlocu-

the 10 day period of rule 59(e). W. SHUFORD, *supra* note 80, § 59-18, at 502. If, however, an appeal is taken before a 59(e) motion is made to transform a previous dismissal into one pursuant to rule 41(a)(2), the trial court does not have jurisdiction to entertain the motion. See *Bowen v. Hodge Motor Co.*, 292 N.C. 633, 234 S.E.2d 748 (1977). Thus, if the party adversely affected by the original dismissal or judgment appeals that order before moving to amend it under rule 59(e), the trial court will not have jurisdiction to consider amending its order. If, on the other hand, the adversely affected party moves to amend under 59(e), the time period for giving notice of appeal does not begin to run until the trial court grants or denies the 59(e) motion. 6A MOORE'S FEDERAL PRACTICE ¶ 59.12[2], at 59-253 (2d ed. 1974).

98. In *Herff Jones Co. v. Allegood*, 35 N.C. App. 475, 241 S.E.2d 700 (1978), the court of appeals held that the question of the propriety of a preliminary injunction to enforce a one year agreement not to compete is rendered moot when during the pendency of the appeal of the order granting the injunction, the one year period had expired. Plaintiff corporation had obtained a preliminary injunction to restrain defendants, its former salesmen, from competing against plaintiff in violation of their employment contracts. Justice Exum issued a writ of supersedeas that had the effect of denying enforcement of the preliminary injunction pending appeal. *Id.* at 477, 241 S.E.2d at 701. By the time the appeal was heard the one year period had expired, thus making the issue moot.

Judge Clark in dissent suggested that the writ of supersedeas should have the effect not only of staying the enforcement of the preliminary injunction but of suspending the running of the noncompetition clause as well. "[O]therwise, the supersedeas in effect would determine the substantive rights of the parties . . . to injunctive relief . . ." *Id.* at 481, 241 S.E.2d at 704 (dissenting opinion).

99. N.C.R. Civ. P. 54(b). The trial judge "may enter a final judgment as to one or more but fewer than all of the claims or parties only if there is no just reason for delay and it is so determined in the judgment." *Id.*

100. See *Oestreicher v. American Nat'l Stores, Inc.*, 290 N.C. 118, 225 S.E.2d 797 (1976).

101. N.C. GEN. STAT. § 1-277 (Cum. Supp. 1977); *id.* § 7A-27 (1969). In addition to orders "affect[ing] a substantial right" these statutes allow an appeal of an interlocutory order that "in effect determines the action and prevents a judgment from which an appeal might be taken," or "discontinues the action" or "grants or refuses a new trial."

102. 294 N.C. 200, 240 S.E.2d 338 (1978).

103. *Id.* at 208, 240 S.E.2d at 343.

tory appeal, while the right to avoid the possibility of two trials on the same issues can be such a substantial right.

In *Waters*, defendant's grant of summary judgment was later set aside by the trial judge because of procedural irregularity.¹⁰⁴ The supreme court ruled that "an order setting aside without prejudice a summary judgment on the grounds of procedural irregularity . . . is not immediately appealable."¹⁰⁵ This decision was based on "both reason and analagous [*sic*] cases."¹⁰⁶ The analogous cases were those holding that orders denying summary judgment and other similar interlocutory orders are not appealable.¹⁰⁷ Viewing "substantial rights" from the perspective of what the defendant loses if there is no immediate appeal the court reasoned that

[a]ll defendant suffers by its inability to appeal [the order setting aside summary judgment] is the necessity of rehearing its motion. The avoidance of such a rehearing is not a "substantial right" entitling defendant to an immediate appeal. Neither, for that matter, is the avoidance of trial which defendant might have to undergo should its motion . . . be denied.¹⁰⁸

Thus, the court indicates that the opportunity to avoid an initial trial is not a substantial right so as to allow an immediate appeal.

The court also reasoned that defendant's rights are "fully and adequately protected" by assigning error on appeal.¹⁰⁹ As shown by *Oestreicher v. American National Stores, Inc.*,¹¹⁰ the "fully and adequately protected" concept, however, is by no means a *test* for determining when there is no right to appeal. In *Oestreicher* the trial court granted summary judgment for defendant on two of plaintiff's three related claims for relief. Although plaintiff theoretically could have protected his rights to recover under the two eliminated claims by assigning error on appeal after the trial of the third claim, the supreme court held that there was an immediate right of appeal because plaintiff had a substantial right to have all three related claims tried at one time.¹¹¹ The dis-

104. *Id.* at 206-07, 240 S.E.2d at 342-43.

105. *Id.* at 208, 240 S.E.2d at 343.

106. *Id.*

107. *Id.* at 208-09, 240 S.E.2d at 344.

108. *Id.* at 208, 240 S.E.2d at 344.

109. *Id.*

110. 290 N.C. 118, 225 S.E.2d 797 (1976).

111. Because virtually any order by a trial court can be assigned as error on appeal it can be argued that there are few situations other than a final judgment or injunction in which the party will not be fully and adequately protected despite an inability to appeal immediately. Thus if adequate protection is the test for a substantial right then the substantial right statutes add nothing to rule 54(b)—in other words, all interlocutory appeals must be certified. This is the federal posi-

inction between *Oestreicher* and *Waters* is that in *Oestreicher*, if an appeal was not immediately allowed, plaintiff would be faced with a trial of the one remaining claim and then, if successful in overturning the summary judgment against his other two related claims, a second trial would be necessary.¹¹² In *Waters*, on the other hand, denial of the right to appeal the setting aside of defendant's summary judgment necessitates only a rehearing of the summary judgment and at most one trial. Thus, a comparison of *Waters* with *Oestreicher* suggests that while the opportunity to avoid an initial trial is not a substantial right, the right to avoid the possibility of two trials is.¹¹³

tion and that of North Carolina before *Oestreicher*. See *Survey of Developments in North Carolina Law, 1976*, 55 N.C.L. REV. 895, 929 (1977).

112. See also *Hudspeth v. Bunzey*, 35 N.C. App. 231, 241 S.E.2d 119, cert. denied, 294 N.C. 736, 244 S.E.2d 154 (1978). The court held that the denial of a motion to amend the answer to assert a compulsory counterclaim affects a substantial right and is immediately appealable under N.C. GEN. STAT. § 1-277 (1969). *Id.* at 234, 241 S.E.2d at 121. The court noted that "failure to assert a compulsory counterclaim will ordinarily bar future action on the claim." *Id.* at 233, 241 S.E.2d at 121. Although it seems that future action should not be barred if the denial of the amendment is later found to be error, an immediate appeal should be allowed to avoid having to try the same issues twice. Thus the substantial right affected in this case is not the bar of a future action on the compulsory counterclaim but the possibility of two trials.

113. The significance of allowing an appeal in order to avoid a possible second trial is apparent in *Tennessee-Carolina Transp., Inc. v. Strick Corp.*, 291 N.C. 618, 231 S.E.2d 597 (1977), and recognized in *Survey of Developments in North Carolina Law, 1977*, 56 N.C.L. REV. 874, 908-09 (1978) ("When an order is made that is destined to affect significantly the later conduct of the trial and that could form the basis for awarding the adversely affected party a new trial, the more economical course to take might well be immediate resolution of the question in the appellate courts."). While the *Waters* court views substantial rights from the perspective of what a party will lose by the inability to appeal, the above view is from an economic perspective.

The one-trial/two-trial distinction should have been employed by the court of appeals in *Jones v. Clark*, 36 N.C. App. 327, 244 S.E.2d 183 (1978), to avoid a piecemeal appeal of a third-party claim. In *Jones* the defendant/seller in a breach of warranty action impleaded as third-party defendants the manufacturer and a firm that had inspected the goods. The trial court granted summary judgment for the inspection firm and the defendants/third-party plaintiffs appealed. The court of appeals, without fully resolving whether defendant had a right to an immediate appeal under the substantial rights statutes, decided the case on the merits. *Id.* at 329-30, 244 S.E.2d at 185. Allowing this uncertified piecemeal appeal was not only a waste of judicial efforts but wrong under the law. Defendant's substantial rights as defined in *Oestreicher* and *Waters* would not have been affected by the inability to immediately appeal the adverse summary judgment on his third-party complaint. If the trial on the underlying claim continues while the third-party claim is appealed, the defendant will unavoidably endure two trials if his appeal on the third-party complaint succeeds. Therefore, because defendant can protect his third-party claim by assigning error in the grant of summary judgment, and because an immediate appeal will not avert the possibility of a second trial, defendant has no substantial right that would allow an uncertified appeal.

The key to this analysis is that the trial on the underlying claim will continue during the appeal of the third-party claim. Section 1-294 states:

When an appeal is perfected as provided by this article it stays all further proceeding in the court below upon the judgment appealed from, or upon the matter embraced therein; but the court below may proceed upon any other matter included in the action and not affected by the judgment appealed from.

N.C. GEN. STAT. § 1-294 (1969) (emphasis added). Although it is not entirely clear whether the

In *Parrish v. Cole*¹¹⁴ the court of appeals considered the question whether a notice of appeal bars a subsequent but timely motion under rule 52(b)¹¹⁵ to amend findings of fact. Under the general rule, a timely notice of appeal terminates the jurisdiction of the trial court and places the case in the appellate court;¹¹⁶ thus the trial court would be precluded from amending its findings of fact. The *Parrish* court rejected this result, however, and held that notice of appeal does not bar a 52(b) motion.¹¹⁷ The court distinguished *Wiggins v. Bunch*,¹¹⁸ in which the North Carolina Supreme Court found a 60(b) motion barred by a prior notice of appeal, by pointing out that a 60(b) motion may be made up to one year after entry of judgment and does not toll the time for filing notice of appeal, while a 52(b) motion must be made within ten days after entry of judgment and does toll the time for filing notice of ap-

italicized portion of the statute will allow the court to try the underlying claim while the third-party claim is appealed, the few cases interpreting this provision indicate that the court below may proceed if the subject matter of the appeal is not the same as that in the underlying action. See *Safie Mfg. Co. v. Arnold*, 228 N.C. 375, 387, 45 S.E.2d 577, 585 (1947) (citing *Herring v. Pugh*, 126 N.C. 852, 36 S.E. 287 (1900)). Under rule 14, defendant/third-party plaintiff can only implead a third-party defendant "who is or may be liable to [the third-party plaintiff] for all or part of the plaintiff's claim against him." N.C.R. Civ. P. 14(a). To recover on a third-party claim the defendant/third-party plaintiff must show (1) he is liable on the plaintiff's claim and (2) the third-party defendant is in turn liable to defendant for indemnification or contribution because of their particular relationship. A determination of nonliability on a third-party claim before the underlying action is resolved necessarily means that the court has determined that the requisite relationship between defendant/third-party plaintiff and third-party defendant did not exist. Such a determination has nothing to do with the subject matter of the underlying claim but only with the relationship between the third-parties plaintiff and defendant. Thus, the underlying claim may proceed under § 1-294. Any holding to the contrary would invite the potential abuse of allowing defendant to delay a trial by simply making many unsubstantial third-party claims and appealing the summary judgments.

The situation involved in *Jones* is clearly distinguishable from *Oestreicher* in which an appeal from a summary judgment on two of plaintiff's three claims for relief was allowed. Because all three claims in *Oestreicher* involved the same subject matter (a breach of a lease agreement) the trial on the remaining claim was stayed under § 1-294 while the appeal was taken. Thus, unlike *Jones*, an appeal in *Oestreicher* could avert the possibility of two trials.

114. 38 N.C. App. 691, 248 S.E.2d 878 (1978).

115. N.C.R. Civ. P. 52(b) provides in part: "upon motion of a party made not later than 10 days after entry of judgment the court may amend its findings or make additional findings and may amend the judgment accordingly."

116. See *American Floor Mach. Co. v. Dixon*, 260 N.C. 732, 133 S.E.2d 659 (1963). There are several exceptions to this rule: the trial court has jurisdiction to settle the case during pendency of appeal, and the trial court may adjudge whether the appeal has been abandoned. *Id.* at 735-36, 133 S.E.2d at 662; see *Bowen v. Hodge Motor Co.*, 292 N.C. 633, 234 S.E.2d 748 (1977).

117. 38 N.C. App. at 694, 248 S.E.2d at 879. In so holding the court relied on *Elgen Mfg. Corp. v. Ventfabrics, Inc.*, 314 F.2d 440 (7th Cir. 1963): "[A] quick filing of notice of appeal by one party [cannot] defeat the adverse party's right to have the district court consider the merits of a timely filed motion under Rule 52(b)." *Id.* at 444. FED. R. Civ. P. 52(b) is equivalent to North Carolina's rule.

118. 280 N.C. 106, 184 S.E.2d 879 (1971).

peal.¹¹⁹ In reaching its decision the court noted that "the primary purpose of Rule 52(b) is to enable the appellate court to obtain a correct understanding of the factual issues determined by the trial court."¹²⁰ The use of rule 52(b) can also help avoid the need for remand by the appellate court for further findings of fact, which may in turn eliminate the possibility of multiple appeals. Because a 52(b) motion must be made within ten days after entry of judgment any disruption in the appellate process will be slight.¹²¹ And as the court correctly pointed out, although an appeal will still be available should either party object to the findings, it is possible that these new or amended findings will satisfy the parties and thus remove the need for an appeal.¹²²

G. *New Trial—Excessive Damages—Rule 59*

If the jury returns a verdict awarding an amount of damages unacceptable to the trial judge, subsections (6) and (7) of rule 59(a) authorize a grant of a new trial¹²³ on the grounds of: "(6) Excessive or inadequate damages appearing to have been given under the influence of passion or prejudice; [or] (7) Insufficiency of the evidence to justify the verdict or that the verdict is contrary to law."¹²⁴ Although historically the decision of the trial judge whether to grant a new trial because of excessive or inadequate damages was not reviewable on appeal,¹²⁵ today federal as well as North Carolina courts recognize that such a new trial order is reviewable for abuse of discretion.¹²⁶ Until the 1978

119. 38 N.C. App. at 695, 248 S.E.2d at 880. As the court noted, "a Rule 60(b) motion has a greater potential for disrupting the appellate process because an appeal may have been substantially advanced at the time the motion is made." *Id.* Another basis for distinction is that in *Wiggins* the same party who made the 60(b) motion had filed the notice of appeal, while in *Parish* plaintiff made the 52(b) motion after defendant had filed his notice of appeal. 280 N.C. at 107, 184 S.E.2d at 879; 38 N.C. App. at 692, 248 S.E.2d at 879.

120. 38 N.C. App. at 694, 248 S.E.2d at 879 (quoting C. WRIGHT, *LAW OF FEDERAL COURTS* § 96 (3d ed. 1976)).

121. *Id.* at 694, 248 S.E.2d at 880.

122. *Id.*

123. When the error relates solely to the amount of damages, the new trial is frequently limited to that issue; however, it may be necessary to order a new trial on both liability and damages when the two issues are closely interwoven. *Survey of Developments in North Carolina Law, 1977*, 56 N.C.L. REV. 843, 909 (1978).

124. N.C.R. Civ. P. 59(a)(6), (7).

125. 11 C. WRIGHT & A. MILLER, *supra* note 37, § 2820, at 127-28.

126. "While the Supreme Court has not explicitly ruled on the question, all eleven Circuits, are today committed to a doctrine that there should be some appellate supervision over the size of jury verdicts." 6A MOORE'S FEDERAL PRACTICE ¶ 59.08[6], at 59-182 (2d ed. 1974). For North Carolina's recognition, see 12 STRONG'S NORTH CAROLINA INDEX 3D *Trial* §§ 52, 52.1 (1978) and cases cited therein.

court of appeals decision *Howard v. Mercer*,¹²⁷ however, there had been no reported North Carolina decision in which an appellate court found such an abuse of discretion.¹²⁸ The *Howard* jury, in a personal injury action in which plaintiff had shown \$5,645 of special damages, returned a total verdict of \$20,000, which the trial judge set aside as "excessive and contrary to the weight of the evidence."¹²⁹ The court of appeals found that it was not unreasonable to award the 59-year-old handyman general damages of \$14,355 for pain, suffering and permanent partial disability in addition to the special damages of \$5,645. They therefore held "that the able trial judge abused his discretion in setting aside the verdict."¹³⁰

The court recognized one trial court and two appellate court standards for determining whether a jury verdict is excessive. These standards were first articulated in *Taylor v. Washington Terminal Co.*,¹³¹ from which the court quoted extensively. According to the *Taylor* analysis, adopted by the court of appeals, the trial judge should determine a "maximum limit of a reasonable range" and if the jury verdict is *obviously outside* that maximum he should grant a new trial or a remittitur.¹³² The scope of appellate review of the trial level decision is limited in two respects, deference to the trial judge's opportunity to observe witnesses and evidence at trial and deference to the jury's finding of fact.¹³³ The standard used in appellate review depends on the force of these two factors. If the trial judge agrees with the jury's verdict and therefore denies a new trial both factors "press in the same direction," hence the "appellate court should be certain indeed that the award is *contrary to all reason*" before finding an abuse of discretion.¹³⁴ If, on the other hand, the trial court sets aside a jury verdict as excessive, the judge factor and the jury factor are at odds, hence the appellate court can find an abuse of discretion if the jury's verdict is *clearly within* the appellate court's maximum reasonable range.¹³⁵ Therefore the two fac-

127. 36 N.C. App. 67, 243 S.E.2d 168, *cert. granted*, 295 N.C. 466, 246 S.E.2d 9 (1978) (No. 132 PC).

128. See *Settee v. Charlotte Elec. Ry.*, 170 N.C. 365, 86 S.E. 1050 (1915), *quoted in* *Setzer v. Dunlap*, 23 N.C. App. 362, 208 S.E.2d 710 (1974); W. SHUFORD, *supra* note 80, § 59-9.

129. 36 N.C. App. at 67, 243 S.E.2d at 169.

130. *Id.* at 73, 243 S.E.2d at 172.

131. 409 F.2d 145 (D.C. Cir.), *cert. denied*, 396 U.S. 835 (1969).

132. 36 N.C. App. at 71, 243 S.E.2d at 171 (citing *Taylor v. Washington Terminal Co.*, 409 F.2d at 147-49).

133. *Id.* at 70, 243 S.E.2d at 170.

134. *Id.* (emphasis added).

135. *Id.* at 71, 243 S.E.2d at 171.

tors limiting appellate review necessitate two standards for that review, the choice between which depends upon whether the new trial was granted or denied.

Howard's significance is not the articulation of these "standards." Indeed, the language of the standards *does not show clearly* the difference between the "obviously outside a reasonable range" standard, the "contrary to all reason" standard and the "clearly within a reasonable range" standard. Rather, the significance of the opinion is that while North Carolina courts in the past have given lip service to the notion that the trial judge could abuse his discretion by denying or granting a new trial for an excessive verdict, they never before have indicated when or even if such a situation could arise.

The *Howard* decision has revealed that in some situations it is easier for the trial judge to abuse his discretion than in others. Thus, if the trial judge sets aside a jury verdict, allowing a new trial or remittitur, he will have abused his discretion if the verdict is clearly within what the appellate court perceives to be a reasonable range, but if he denies the new trial he can only be overturned if the verdict is contrary to all reason. The court makes it clear that there is a difference between these two standards and under the latter, the trial judge's determination is less apt to be reversed.¹³⁶ This case, therefore, will have the effect of making trial judges wary of setting aside jury verdicts even if they think they are excessive. It is ironic that this first affirmative exercise of the court of appeals's right to review the amount of jury awards could lead to more excessive awards. It is hoped, however, that the court of appeals, having taken the necessary first step, will also be willing to find

136. This decision should not be read to imply that a trial judge should only under the most extraordinary circumstances be found to have abused his discretion if he *denies* a new trial. Indeed, many federal appellate courts have reversed trial court denials of a new trial when they thought the verdict was excessive. See 11 C. WRIGHT & A. MILLER, *supra* note 37, § 2820, at 128-29 nn. 84 & 85 (1973 & Supp. 1978). Some courts view a reversal of the trial court's denial of a new trial as tantamount to finding that the trial judge abused his discretion in not finding the jury abused their discretion. See, e.g., *Miller v. Maryland Cas. Co.*, 40 F.2d 463, 465 (2d Cir. 1930) (Learned Hand, J.). Under such a "discretion squared" argument it seems there could be no appellate reversal of a trial judge's denial to grant a new trial on grounds of an excessive verdict. The better view, however, is that such a reversal, although rare, can occur in the appropriate case. The "contrary to all reason" standard for reversal of a denial of a new trial, announced in the *Taylor* case, seems to give little help in discerning the instances when a denial of a new trial should be reversed. Perhaps the "contrary to all reason" standard can be likened to the "clearly within the reasonable range" standard except the reasonable range would be larger if the trial judge agreed with the jury (and hence denied a new trial) than if he disagreed (and hence ordered a new trial or a remittitur).

abuse of discretion in the denial of a new trial when it is convinced a verdict is excessive.

H. Relief from Judgments—Rule 60(b)

Rule 60(b) provides that "[o]n motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order, or proceeding."¹³⁷ Among the reasons for allowing this relief are "excusable neglect" and "any other reason justifying relief from the operation of the judgment."¹³⁸ Three cases last year, *Standard Equipment Co. v. Albertson*,¹³⁹ *Sides v. Reid*,¹⁴⁰ and *Texas Western Financial Corp. v. Mann*,¹⁴¹ indicate that the court of appeals is misapplying rule 60(b) by minimizing the trial judge's discretionary power to set aside judgments.

In all three cases a default judgment was initially entered against one of the parties but later set aside by the trial judge under rule 60(b). In *Standard Equipment* and *Texas Western*, the court of appeals reversed the trial judge's order to set aside because it did not agree that the conduct leading to default was excusable.¹⁴² In *Sides*, the court of appeals reversed a trial judge's reopening a judgment under the "any other reason" provision of rule 60(b) because it did not think the reasons were sufficiently compelling.¹⁴³ These decisions can be criticized

137. N.C.R. Civ. P. 60(b).

138. *Id.* There are four other reasons for relief set out in rule 60(b). In addition to finding one of the appropriate reasons, the trial court, in order to set aside a judgment, must also find that the movant has a meritorious claim or defense. Sawyer v. Sawyer, 1 N.C. App. 400, 161 S.E.2d 625 (1968); W. SHUFORD, *supra* note 80, § 60-2, at 504.

139. 35 N.C. App. 144, 240 S.E.2d 499 (1978).

140. 35 N.C. App. 235, 241 S.E.2d 110 (1978).

141. 36 N.C. App. 346, 243 S.E.2d 904 (1978).

142. 35 N.C. App. at 147, 240 S.E.2d at 501; 36 N.C. App. at 349, 243 S.E.2d at 907.

143. 35 N.C. at 238, 241 S.E.2d at 112. The court in the *Sides* case refused to consider the motion as one under rule 60(b)(1) for excusable neglect, but rather interpreted the motion as one under 60(b)(6) which allows relief from a judgment for "any other reason justifying relief from the operation of the judgment." *Id.* at 237, 241 S.E.2d at 112. This refusal was because "defendant did not assert *excusable neglect* as a grounds for relief nor did the trial court find the same as fact in its order setting aside the judgment." *Id.* at 237, 241 S.E.2d at 112. The movant, however, need not specify in his motion which 60(b) ground he is proceeding under, *Brady v. Town of Chapel Hill*, 277 N.C. 720, 178 S.E.2d 446 (1971), nor is the trial judge required to find the facts upon which he bases his order absent a request to do so, *Commercial Union Assurance Cos. v. Atwater Motor Co.*, 35 N.C. App. 397, 241 S.E.2d 334 (1978). Furthermore, defendant's motion to set aside asserted that he did not properly answer the complaint because "not being familiar with the legal requirements and not having the financial resources to employ counsel" he thought that a letter to the Clerk of Superior Court setting forth his defenses would be a sufficient answer. Record on Appeal at 21. This motion is easily interpretable as asserting an excuse for defendant's default. Thus, the court of appeals' conclusion that "defendant did not assert excusable neglect as a grounds for relief" appears unjustified.

because it is questionable whether a grant of a 60(b) motion is immediately appealable and because the determination of whether a set of facts constitutes "excusable neglect" should be within the sound discretion of the trial judge and reviewable only for abuse of discretion.

Under the federal rules a grant of a 60(b) motion to reopen a judgment is usually an interlocutory order and hence unappealable.¹⁴⁴ North Carolina, however, unlike the federal courts, allows an immediate appeal of a grant of a new trial.¹⁴⁵ Frequently it is necessary for the trial judge to hold a hearing to determine damages before entering the default judgment.¹⁴⁶ Vacating such a default judgment may be analogized to a grant of a new trial thus allowing an immediate appeal. If, on the other hand, a default judgment has been entered without a hearing, for example, when the damages are a sum certain and the opposing party has failed to appear,¹⁴⁷ reopening this judgment would not be analogous to an order of a new trial because there was no first "trial." Appealability might be found nevertheless under the North Carolina statutes that allow an immediate appeal from orders that affect a "substantial right."¹⁴⁸ The supreme court, however, has held that the setting aside of a summary judgment is not immediately appealable because the possibility of avoiding a trial if the summary judgment is reinstated is not a "substantial right."¹⁴⁹ It is difficult to see why the setting aside of a default judgment should be treated any differently.¹⁵⁰ Thus, although the court of appeals has been allowing 60(b) appeals

144. 7 MOORE'S FEDERAL PRACTICE § 60.30[3], at 431 (2d ed. 1978).

145. N.C. GEN. STAT. § 1-277 (Cum. Supp. 1977); *id.* § 7A-27 (1969).

146. A hearing may be necessary "to take an account or to determine the amount of damages or to establish the truth of any averment by evidence or to take an investigation of any other matter." N.C.R. CIV. P. 55(b)(2).

147. The clerk can enter a default judgment "[w]hen the plaintiff's claim against a defendant is for a sum certain or for a sum which can by computation be made certain" and the defendant who is not an infant or incompetent has failed to appear. *Id.* 55(b)(1). The default judgments in *Texas Western* and *Sides* were granted pursuant to this rule. See 36 N.C. App. at 347, 243 S.E.2d at 905; 35 N.C. App. at 236, 241 S.E.2d at 111.

148. N.C. GEN. STAT. § 1-277 (Cum. Supp. 1977); *id.* § 7A-27 (1969).

149. See *Waters v. Qualified Personnel, Inc.*, 294 N.C. 200, 240 S.E.2d 338 (1978), discussed in text accompanying notes 99-113.

150. When the "substantial rights" test is viewed from the perspective of what a party will suffer or lose if an appeal is not allowed, as did the court in *Waters*, it would seem that appealability of a setting aside of a default judgment is even less compelling than that for the setting aside of a summary judgment. To win on summary judgment the prevailing party makes an adversary presentation after discovery leading to the conclusion that there are no remaining issues of material fact. For a default judgment, on the other hand, all that is often required is an ex parte showing that the defendant has been properly served with process. Thus, it can be argued that a party who loses a default judgment loses only a windfall whereas a party who loses a summary judgment loses a ruling obtained at considerably more effort. Therefore, if losing a summary judgment does not affect a "substantial right," *a fortiori*, losing a default judgment does not.

without discussion, the reopening of a default judgment entered without a hearing should not be appealable as a grant of a new trial or as affecting a substantial right.

Not only has the court of appeals improvidently accepted these 60(b) appeals, it has not shown proper deference to the trial judge's discretion to reopen a judgment for excusable neglect. The court consistently holds in cases in which a default judgment has been set aside that the determination of whether a particular set of facts constitutes excusable neglect is a matter of law that is reviewable on appeal rather than a discretionary ruling reviewable only for abuse.¹⁵¹ According to the court of appeals' interpretation of rule 60(b), it is only when the facts constitute an excuse as a matter of law, and there is a meritorious defense, that the trial judge may exercise his discretion and set aside a judgment.¹⁵² Although the federal rule 60(b) is virtually identical to North Carolina's, the federal courts, unlike our court of appeals, respect the trial judge's discretion in the determination of excusable neglect. The federal practice is summarized by Professor Moore:

If the District Court has power to grant relief, then its determination to grant or deny relief normally involves a discretionary appraisal of the facts of the particular case and the relief, if any, to be granted: This matter, then, is largely within the judicial discretion of the trial court.

. . . .

Where timely relief is sought from a default judgment and the movant has a meritorious defense, doubt, if any, should be resolved in favor of the motion to set aside the judgment so that cases may be decided on their merits. . . . [although l]itigants and their counsel may not properly be allowed to disregard process or procedural rules with impunity.¹⁵³

Under the federal interpretation the threshold question in determining whether the trial judge has discretionary power to set aside a judgment is whether the motion *states any reason* for relief under 60(b).¹⁵⁴ Thus, if the movant offers no excuse for his neglect nor any other reason for reopening the judgment, the trial judge does not have

151. The rule that excusable neglect is a question of law is traceable to *Ellison v. White*, 3 N.C. App. 235, 164 S.E.2d 511 (1968), *cert. denied*, 275 N.C. 137 (1969). *Ellison* in turn relies on 2 A. MCINTOSH, NORTH CAROLINA PRACTICE AND PROCEDURE § 1717 (2d ed. 1956), which, at *id.* § 1717(b) n.69, cites four supreme court cases from the early 1900's. These four cases rely on earlier supreme court precedent, the earliest being *Powell v. Weith*, 68 N.C. 342 (1872).

152. See 2 A. MCINTOSH, *supra* note 151, § 1717.

153. 7 MOORE'S FEDERAL PRACTICE ¶ 60.19, at 227-35 (2d ed. 1978).

154. *Id.* at 226. The motion also must have been made within the maximum time period allowed in the rule.

the power to exercise his discretion to set it aside. In all three cases above, however, the movants did offer colorable excuses for their defaults.¹⁵⁵ Therefore, under the federal interpretation, the trial judge would have had discretionary power, reviewable only for abuse, to set aside the judgments. A mere disagreement with the trial judge about the validity of the excuse should not be a sufficient reason to reverse a discretionary trial court ruling.¹⁵⁶

The court of appeals' interpretation of rule 60(b) is inconsistent with that of federal courts. Although the North Carolina Supreme Court has specifically stated that it will look to federal decisions under rule 60(b) "for interpretation and enlightenment,"¹⁵⁷ the court of appeals judges have seemingly not consulted those interpretations of 60(b), assuming instead that rule 60(b) continued the prior North Carolina law on excusable neglect.¹⁵⁸ The supreme court, however, has never made such a determination.¹⁵⁹

The supreme court cases ultimately relied on by the court of appeals for the proposition that excusable neglect is a matter of law reviewable on appeal date from the early part of this century. Because the North Carolina Court of Appeals interpretation of recently enacted rule 60(b) is vastly different from the federal interpretation of a virtually identical rule, the supreme court should consider whether the federal interpretation should be the law of North Carolina.

155. It did not appear that the movants disregarded the process and procedure rules with impunity. In *Standard Equipment*, plaintiff's excuse for default was that he had no notice of trial because he did not receive the trial calendar after discharging his attorney of record. 35 N.C. App. at 145, 240 S.E.2d at 500. Defendant's excuse in *Texas Western* was that plaintiff's attorney had misrepresented to defendant that defendant would be allowed to inspect plaintiff's files (apparently before answering). 36 N.C. App. at 347, 243 S.E.2d at 905. Defendant's excuse in *Sides* was that he thought a letter to the Clerk of Superior Court sufficed as an answer. See note 143 *supra*.

156. It cannot be argued that the court of appeals is actually finding an abuse of discretion in reversing these 60(b) grants of relief in *Standard Equipment* and *Texas Western*. *Ellison v. White*, 3 N.C. App. 235, 164 S.E.2d 511 (1968), *cert. denied*, 275 N.C. 137 (1969), relied on by the court of appeals in both *Standard Equipment* and *Texas Western* (indirectly in *Standard Equipment*), specifically states that because the court of appeals did not think there was excusable neglect as a matter of law, they "do not reach the question as to whether there was an abuse of discretion by the trial judge." *Id.* at 242, 164 S.E.2d at 515-16.

157. *Wiggins v. Bunch*, 280 N.C. 106, 110, 184 S.E.2d 879, 881 (1971).

158. See *Doxol Gas, Inc. v. Barefoot*, 10 N.C. App. 703, 179 S.E.2d 890 (1971).

159. The supreme court did deny certiorari in *Kirby v. Asheville Contracting Co.*, 11 N.C. App. 128, 180 S.E.2d 407, *cert. denied*, 278 N.C. 701, 181 S.E.2d 602 (1971), which stated that the cases under former North Carolina excusable neglect law are still applicable under rule 60(b).

In *Brady v. Town of Chapel Hill*, 277 N.C. 720, 178 S.E.2d 446 (1971), the supreme court said that the procedure under rule 60(b) is *analogous* to that under prior law. *Id.* at 724, 178 S.E.2d at 448 (emphasis added). In the context of that case this statement should be taken to mean only that relief from an irregular judgment is obtainable through a motion to the trial court, not through appeal.

There are strong arguments for the federal interpretation of rule 60(b). First, the federal interpretation is fairer to the parties involved. Only the trial judge is aware of the many nuances that could lead to a decision to reopen a judgment because of excusable neglect. To allow a detached appellate court to reverse that determination deprives the losing party of a firsthand determination of his rights only to reinstate a windfall for his opponent. Second, the federal approach saves judicial time. There are an infinite number of factual settings that could give rise to excusable neglect. Allowing an appellate court to review each situation to determine the sufficiency of an excuse is a time consuming process yielding little precedential value because of the unique factual settings. Finally, a major consideration in determining whether an issue should be a matter of law fully reviewable on appeal or a discretionary determination reviewable only for abuse is the desirability of a fixed legal standard that can be relied on in the planning of future conduct. If a fixed legal standard for excuse exists, arguably the conduct of litigants will tend to be just on the excusable side of this legal limit, whereas if there were no precise legal formulation of excusable neglect, litigants would tend to be more cautious, not knowing whether a particular trial judge in his discretion would find their conduct excusable. Thus, a discretionary standard for excusable neglect is preferable to a fixed legal standard because the former will encourage litigants to be more cautious by not providing a sure escape from certain legally excusable, neglectful conduct.¹⁶⁰

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160. Just as the court of appeals in *Standard Equipment and Texas Western* underemphasized the trial judge's discretion in the excusable neglect determination, the court in *Standard Equipment* and *Sides* did the same to the trial judge's determination of what is "any other reason justifying relief from the operation of the judgment." Furthermore, just as with excusable neglect, the federal interpretation of the "other reasons" clause is that if the trial judge has the power to grant relief then his determination is reversible only for abuse of discretion. 7 MOORE'S FEDERAL PRACTICE ¶ 60.27[1], at 351-52 (2d ed. 1978). It is true that even under the federal interpretation "absent exceptional and compelling circumstances, a party will not be granted relief from a judgment under the [any other reason] clause." *Id.* at 348. Once, however, the trial judge grants such relief it should not be permissible for an appellate court to reverse merely because it does not think that as a matter of law the situation was exceptional or compelling enough.

Additional Developments. In *Wachovia Mortgage Co. v. Autry-Barker-Spurrier Real Estate, Inc.*, 39 N.C. App. 1, 249 S.E.2d 727 (1978), the court of appeals held that the party opposing a motion for summary judgment cannot create an issue of fact simply by filing an affidavit contradicting his testimony taken via deposition. In this situation the only issue possibly raised by the affidavit is the affiant's credibility. *Id.* at 9, 249 S.E.2d at 732. The court of appeals followed the rationale of the federal court's decision in *Perma Research & Dev. Co. v. Singer, Co.*, 410 F.2d 572 (2d Cir. 1969), in which the court noted that "[i]f a party who has been examined at length on

III. COMMERCIAL LAW

A. The Uniform Commercial Code

1. Negotiable Instruments

a. Treatment of Branches as Separate Banks

In *North Carolina National Bank v. Harwell*,¹ the North Carolina Court of Appeals faced for the first time the question of the applicability and effect of G.S. 25-4-106,² which deals with the status of branch and separate bank offices as separate banks for certain purposes under Articles 3 and 4 of the Uniform Commercial Code.³ In *Harwell*, a check was drawn on the drawer's account with the Wilmington branch of North Carolina National Bank (NCNB) and was presented at that branch by defendant for deposit to his account in the High Point branch of NCNB.⁴ The check was subsequently dishonored because of insufficient funds and the amount of the check was charged back against the provisional credit that had been entered on defendant's account.⁵ Prior to the time he received the notice of dishonor, defendant drew a check on his account that caused the bank's subsequent charge-

deposition could raise an issue of fact simply by submitting an affidavit contradicting his own prior testimony, this would greatly diminish the utility of summary judgment as a procedure for screening out sham issues of fact." *Id.* at 578. For the reasons stated by the *Perma* court, the adoption of this rule by the North Carolina court is sensible.

A trial court's entry of default judgment as a sanction for defendant's failure to attend a scheduled deposition was approved by the court of appeals in *Cutter v. Brooks*, 36 N.C. App. 265, 243 S.E.2d 423 (1978). N.C.R. Civ. P. 37(d) authorizes the imposition of certain sanctions upon any party who fails to "appear before the person who is to take his deposition, after being served with proper notice." (These sanctions, enumerated in 37(b)(2)(a)-(c), range from an order that certain facts be deemed established to an order for entry of default judgment.) In ruling on the propriety of the trial court's action, the court of appeals cited the comment to 37(d), which suggests that the flexibility of sanctions available "eliminates any need to retain the requirement that the failure to appear or respond be 'willful' [I]n view of the possibility of light sanctions, even a negligent failure should come within Rule 37(d)." See 8 C. WRIGHT & A. MILLER, *supra* note 38, §§ 2281, 2284. The court of appeals indicated its concurrence in this interpretation of 37(d) by finding that the trial court did not abuse its discretion in entering a default judgment even though defendant's failure to appear was not willful. 36 N.C. App. at 267-68, 243 S.E.2d at 424; see 8 C. WRIGHT & A. MILLER, *supra*, § 2291. The decision in *Cutter* may foreshadow a movement toward increased use of sanctions as a means of streamlining the litigation process.

1. 38 N.C. App. 190, 247 S.E.2d 720 (1978), *cert. denied*, 296 N.C. 410, 251 S.E.2d 468 (1979).

2. N.C. GEN. STAT. § 25-4-106 (Cum. Supp. 1977) provides: "A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given under this article and under article 3."

3. *Id.* §§ 25-3-101 to -4-407 (1965 & Cum. Supp. 1977).

4. 38 N.C. App. at 191, 247 S.E.2d at 721.

5. *Id.*

back to result in an overdraft.⁶ After defendant refused the bank's request for reimbursement, NCNB brought an action to recover the overdraft.⁷ Defendant appealed from the trial court's summary judgment for the bank.

On appeal, defendant argued that the bank's charge-back was improper because notice of dishonor was not sent within the midnight deadline from the time defendant presented the check for deposit,⁸ as is required under the Code when the bank qualifies as both the "payor" and "depository" bank.⁹ The bank argued, however, that the Wilmington and High Point branches qualify as separate payor and depository banks pursuant to G.S. 25-4-106¹⁰ and that notice of dishonor was sent to the customer by the High Point branch well within the time period prescribed by the Code section governing the right to charge-back of a nonpayor bank.¹¹ The court of appeals held that the two branches,

6. Defendant had written a \$3,300 check on his account with the High Point branch. The subsequent charge-back of the \$3,356.32 dishonored check resulted in an overdraft in defendant's account of \$3,282.98. *Id.*

7. *Id.*; see N.C. GEN. STAT. § 25-4-212(1) (1965).

8. The "midnight deadline" with respect to a bank "is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later." N.C. GEN. STAT. § 25-4-104(h) (1965). The check was presented for deposit at the Wilmington branch on a Friday, but since it was presented after the bank's "cutoff hour" it was treated for purposes of the notice requirements as being presented at the opening of the banking day on the following Monday. 38 N.C. App. at 191, 247 S.E.2d at 724; see N.C. GEN. STAT. § 25-4-107 (1965). The check was dishonored on Tuesday and notice of dishonor and the dishonored check itself were sent to the High Point branch. Notice of dishonor was not sent to defendant, however, until Wednesday. Thus, under one construction, notice was not sent to defendant until a day after the running of the midnight deadline. 38 N.C. App. at 191, 247 S.E.2d at 721.

9. A payor bank is a "bank by which an item is payable as drawn or accepted," while a depository bank is "the first bank to which an item is transferred for collection even though it is also the payor bank." N.C. GEN. STAT. § 25-4-105(a), (b) (1965). If a bank is both the depository and payor bank, its right to charge-back is governed by *id.* § 25-4-212(3), which provides that the charge-back must be "in accordance with the section governing return of an item received by a payor bank for credit on its books." The relevant section states that the bank, in order to revoke credit or recover any amount withdrawn, must return the check or send notice of dishonor before final payment is made and before its midnight deadline. *Id.* § 25-4-301(1), (2).

10. Quoted in note 2 *supra*.

11. N.C. GEN. STAT. § 25-4-212(1) (1965), governing the right to charge-back of the nonpayor, collecting bank, provides:

If a collecting bank has made a provisional settlement with its customer for an item and itself fails by reason of dishonor . . . to receive a settlement for the item which is . . . final, the bank may revoke the settlement given by it, charge-back the amount of any credit given for the item to its customer's account or obtain a refund from its customer . . . if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. These rights to revoke, charge-back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final

If the High Point branch is treated as the separate collecting bank, plaintiff correctly argued that the High Point branch preserved its right to charge-back by sending notice of dishonor on

whose ledgers were administered at separate operations centers,¹² should be treated as separate banks and that the High Point branch had preserved its right to charge-back when it sent notice of dishonor within the midnight deadline after it learned of the dishonor from the Wilmington branch.¹³ The decision is apparently the first in the country in which section 4-106 of the Uniform Commercial Code has been utilized to reach a result favorable to a bank in a case involving the timeliness of notice of dishonor.¹⁴

In support of its application of G.S. 25-4-106 the court of appeals pointed to several factors. First, the court thought that the 1967

Wednesday. A provisional credit was entered in defendant's High Point account, and the High Point branch failed to receive a final settlement of the item by reason of dishonor. 38 N.C. App. at 191, 247 S.E.2d at 721. No final payment of the item occurred under the separate bank construction of the transaction since the Wilmington branch sent notice of dishonor to the collecting High Point branch within the midnight deadline from the time it received the item. See N.C. GEN. STAT. § 25-4-213 (1) (1965). Finally, the High Point branch sent notice of dishonor to defendant on the same day it learned of the dishonor from the Wilmington branch, well within its midnight deadline. 38 N.C. App. at 191, 247 S.E.2d at 721.

12. The drawer's account with the Wilmington branch was administered through NCNB's Eastern Operations Center in Raleigh. Defendant depositor's account with the High Point branch was administered through NCNB's Western Operations Center in Charlotte. 38 N.C. App. at 194, 247 S.E.2d at 723.

13. *Id.* at 195, 247 S.E.2d at 723. The court also noted that the High Point branch received no final settlement on the item that would terminate its right to charge-back since the Wilmington branch acted within its midnight deadline. *Id.* at 198, 247 S.E.2d at 725. It is unclear from the court's opinion when the Wilmington branch's midnight deadline began to run. Presumably it would begin to run from the day the check was presented for payment at the Wilmington branch. Defendant presented the check in Wilmington for deposit to his High Point account and a provisional credit was wired to defendant's High Point ledger from the Eastern Operations Center. The court treated the High Point branch as the collecting bank and transferor of the check for payment, although it did not have physical possession of the check until after it was dishonored and sent to High Point from the Eastern Operations Center. *Id.* at 196, 247 S.E.2d at 724. The court apparently construed presentment for payment by the High Point branch as occurring on Monday when the provisional credit was wired from Wilmington. Under this construction, the legal date of presentment for deposit by defendant payee and presentment for payment by the collecting bank both occurred on Monday. See N.C. GEN. STAT. § 25-4-107; note 8 *supra*. Thus, it is not clear if the running of the midnight deadline for the payor bank's right to send notice of dishonor began when it came into physical possession of the check or when the legal presentment for payment was made. In a more typical collecting transaction this problem would not occur because the payor bank does not come into physical possession of the check until presentment for payment is made; yet it could be important in a case such as *Harwell* if physical possession and presentment for payment were to occur on different days. The better rule would seem to be that the deadline should begin to run when the payor bank comes into physical possession of the instrument even if it precedes legal presentment for payment by the collecting branch, because this is the event that begins the collection process.

14. The few other reported decisions that could have applied the section in such cases either refused to apply it or found it unnecessary for the decision. See *Manufacturers Hanover Trust Co. v. Akpan*, 91 Misc.2d 622, 398 N.Y.S.2d 477 (Civ. Ct. N.Y. 1977) (refusing to apply § 4-106 to preserve branch bank's right to charge-back when notice of dishonor was sent to branch by central office two days after midnight deadline); *Kirby v. First & Merchant's Nat'l Bank*, 210 Va. 88, 168 S.E.2d 273 (1969) (decided on ground that check that bank attempted to dishonor and charge-back had been finally paid over the counter for cash).

amendment to G.S. 25-4-106¹⁵ deleting the provision requiring maintenance of separate ledgers for qualification as a separate bank was indicative of legislative intent to encourage a more liberal application of the section.¹⁶ In addition the court noted that the two branches, operating through separate operation centers, functioned as two separate banks in the collection process and therefore presented a situation for which G.S. 25-4-106 was drafted.¹⁷

The decision seems sound; it provides consistent support for the legislature's encouragement of statewide branch banking¹⁸ without greatly sacrificing the interests of the customer.¹⁹ The question of how far courts will be willing to extend the application of *Harwell* and G.S. 25-4-106 remains.²⁰ The *Harwell* holding is limited to its facts and leaves open the question of the applicability of G.S. 25-4-106 to situations involving two branches operating through the same operations center.²¹ Careful examination of the court's reasoning suggests, however, that although the section probably will not be applied in timeli-

15. Law of May 23, 1967, ch. 562, § 1, 1967 N.C. Sess. Laws 603. The former version of § 25-4-106 stated:

A branch or separate office of a bank *maintaining its own deposit ledgers* is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given under this article and under article 3.

Law of May 26, 1965, ch. 700, § 1, 1965 N.C. Sess. Laws 768 (emphasis added). The 1967 amendment deleted the italicized phrase, an optional provision in the official version of the Uniform Commercial Code. See U.C.C. § 4-106. For the current version of § 25-4-106, see note 2 *supra*.

16. 38 N.C. App. at 194, 247 S.E.2d at 723.

17. *Id.* at 194-95, 247 S.E.2d at 723.

18. See N.C. GEN. STAT. § 53-62 (1975 & Cum. Supp. 1977). The record suggests that the bank needed the extra time in sending notice of dishonor provided by separate bank status because it operated through two separate operations centers. A requirement of processing checks as quickly as if it had only one processing center would create hardships for the bank and discourage the growth of statewide branch banking. See 38 N.C. App. at 194, 247 S.E.2d at 723.

19. Although defendant received notice one day later than would be required if the whole NCNB branch system were treated as one bank for purposes of notice, use of the extra time was reasonable. Two branches, operating through separate administration centers, required longer to process the check. The dishonor notice had to be sent from the payor Wilmington branch to the collecting High Point branch, and then to the customer. If defendant had wanted quicker verification of the sufficiency of funds in the drawer's account he could have presented the check for payment at the Wilmington branch. Instead, defendant chose to deposit the check in his High Point account by presentment in Wilmington. The customer benefited from the convenience of the statewide branch banking system and should not be heard to complain when he must wait an extra day for verification of the validity of the check.

20. The court made clear that application of § 25-4-106 is not mandatory. 38 N.C. App. at 193, 247 S.E.2d at 722.

21. "Since each branch operates through a different operations center, it is not necessary to determine whether two branches operating through the same operations center should be entitled to separate bank status." 38 N.C. App. at 195, 247 S.E.2d at 723. The court, however, placed strong emphasis on the functionally separate nature of the two branches as justification for the longer time period for sending notice of dishonor. *Id.* at 194, 247 S.E.2d at 723. This logic would

ness of notice cases involving branches administered through the same operations center, the court may apply G.S. 25-4-106 for other purposes regardless of the presence of a common center.²²

b. Proof of Loss Sustained from Wrongful Payment of a Check

Pursuant to G.S. 25-4-403(1) the drawer of a check has the right to prevent payment of the check by sending a timely stop payment order to the drawee bank.²³ If the check is paid in violation of a binding order, the drawer may proceed against the bank, but has the burden under G.S. 25-4-403(3) of establishing "the fact and amount of loss resulting from the payment."²⁴ In *Mitchell v. Republic Bank & Trust Co.*,²⁵ the North Carolina Court of Appeals for the first time faced the issue of what constitutes such proof of loss.

Defendant bank paid a check contrary to its customer's valid stop payment order and deducted the amount of the check from the drawer's account.²⁶ The drawer's appointed receiver brought an action seeking damages in the face amount of the check plus interest.²⁷ Admitting payment of the check contrary to the stop payment order, the bank, as subrogee to the rights of the payee²⁸ pursuant to G.S. 25-4-407,²⁹ denied that plaintiff had suffered any loss by payment. The trial court then granted plaintiff's motion for summary judgment before defendant had received answers to its interrogatories concerning the facts underlying the transaction between the drawer and payee of the

not support application of § 25-4-106 in dishonor notice timeliness cases involving common operations centers.

22. For text of statute, see note 2 *supra*. Perhaps a stop payment order delivered to one branch should not function as notice to other branches of the same bank that are administered through the same operations center to prevent the bank from making payment on the check without incurring liability for wrongful payment over a valid stop payment order. See generally N.C. GEN. STAT. § 25-4-106, Official Comment (1965).

23. N.C. GEN. STAT. § 25-4-403(1) (1965).

24. *Id.* § 25-4-403(3).

25. 35 N.C. App. 101, 239 S.E.2d 867 (1978).

26. *Id.* at 102, 239 S.E.2d at 868.

27. *Id.* at 103, 239 S.E.2d at 869.

28. *Id.* at 102, 239 S.E.2d at 868.

29. N.C. GEN. STAT. § 25-4-407 (1965) provides for this subrogation right as follows:

If a payor bank has paid an item over the stop payment order of the drawer . . . , to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

(a) of any holder in due course on the item against the drawer or maker; and

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose

check.³⁰ On appeal the bank argued that the summary judgment was erroneous because a genuine issue of material fact—the “fact and amount of loss”—remained. In support of its position the bank noted that the answers to the interrogatories would possibly reveal that the payee had a claim against plaintiff up to the face amount of the check on either the underlying transaction³¹ or the drawer’s engagement.³² Therefore, the bank concluded, plaintiff, by alleging no more than the payment of the face amount of the check, had failed to establish his right to recover.³³

The court of appeals agreed with the bank’s conclusion and vacated the trial court’s grant of summary judgment. The court held that if a bank pleads non-loss by the customer, the customer “must show some loss other than the mere debiting of his bank account in the amount of the check” in order to recover for payment contrary to a valid stop payment order.³⁴ The court reasoned that because the bank was subrogated to the rights of the payee pursuant to G.S. 25-4-407(b), through which it may have reduced the amount of its liability, it would be improper to define the term “loss” in G.S. 25-4-403(3) to mean the face amount of the check.³⁵ The court stated further that a drawer-customer can establish a *prima facie* case under G.S. 4-403 by showing that the bank paid a check in violation of a valid stop payment order. “Then the bank, exercising its subrogation rights created by G.S. 25-4-

30. 35 N.C. App. at 102, 239 S.E.2d at 868.

31. The Code provides that the taking of a check for payment suspends the underlying obligation until presentment and that if the check is dishonored, action may be maintained on either the instrument or the underlying obligation. N.C. GEN. STAT. § 25-3-802(1)(b) (Cum. Supp. 1977).

32. “The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up.” *Id.* § 25-3-413(2) (1965).

33. See Appellant’s Brief at 4-6.

34. 35 N.C. App. at 103, 239 S.E.2d at 869.

35. *Id.* Even though the defendant may have a good defense to plaintiff’s claim under § 25-4-403 for the face amount, payment of the check may still result in damages for which plaintiff may recover under the Code. For example, payment of a check over a valid stop payment order may create a deficiency in the drawer’s account causing subsequently drawn checks to be dishonored for insufficient funds and may give rise to an action under N.C. GEN. STAT. § 25-4-402 (1965), which provides: “A payor bank is liable to its customer for damages proximately caused by wrongful dishonor of an item.” The dishonor of the subsequently drawn checks is wrongful if the condition of insufficient funds in the customer’s account was created by improper conduct on the part of the bank. The customer’s statutory right to stop payment of a check is not grounded in the customer’s assertion of a valid claim against the payee and, as such, payment in violation of a valid stop payment order is considered improper payment regardless of the merits of the underlying transaction. See *id.* § 25-4-403, Official Comment No. 8. See also *Sunshine v. Bankers Trust Co.*, 34 N.Y.2d 404, 413 n.5, 314 N.E.2d 800, 865 n.5, 358 N.Y.S.2d 113, 121 n.5, *modified*, 34 N.Y.2d 994, 318 N.E.2d 608, 360 N.Y.S.2d 419 (1974).

407, has the burden of coming forward and presenting evidence of an absence of actual loss sustained by the customer. When the bank meets the burden of coming forward, the customer must sustain the ultimate burden of proof."³⁶

The holding in *Mitchell* gives meaning to the proof of loss requirement in G.S. 25-4-403(3). A proceeding under G.S. 25-4-403(1) requires a showing that the bank paid a check contrary to the customer's order, an event that necessarily involves debiting the amount of the check to the customer's account. Surely, therefore, the proof of loss language contained in subsection (3) was intended to require that the customer show more than the mere debiting to his account of the face amount of the check before the customer is allowed to recover for violation of his stop payment order.

It is still unclear, however, what should be considered sufficient proof of "actual loss" by the customer. Presumably a defendant bank may assert, as was done in *Mitchell*, that the payee has a valid claim to which defendant is subrogated for all or part of the face amount of the check and the customer will be required to show actual loss by establishing that he has a valid defense to payment. A customer might, however, be required to show that he has exhausted his remedy of recovering payment from the payee.³⁷ Thus, a customer could be required to litigate against the payee,³⁸ reduce the claim to judgment, and demonstrate that the payee is "judgment proof" before the customer would be held to have established "actual loss" due to payment of the check in violation of the stop payment order. While not discussed by the court, this additional litigation requirement should not be placed on the customer since it would appear to conflict with the overall policy expressed in G.S. 25-4-403 that the customer's right to stop payment "is a service to which he is entitled without regard to any inconvenience or occasional loss to the bank, and such right need not be predicated on proof of sound legal grounds" arising out of the underlying transaction.³⁹

36. 35 N.C. App. at 104, 239 S.E.2d at 869 (citing *Thomas v. Marine Midland Tinkers Nat'l Bank*, 86 Misc. 2d 284, 381 N.Y.S.2d 797 (Civ. Ct. N.Y. 1976)).

37. This requirement might be pressed by a defendant bank on the ground that absent such a showing the customer has failed to demonstrate that his economic position has actually been damaged by the payment.

38. The customer could bring suit against the payee under a theory of unjust enrichment.

39. *Thomas v. Marine Midland Tinkers Nat'l Bank*, 86 Misc. 2d 284, 287, 381 N.Y.S.2d 797, 800 (1976) (citations omitted).

2. Letters of Credit

The North Carolina Supreme Court had an opportunity in *O'Grady v. First Union National Bank*⁴⁰ to discuss the issue of the rights of a customer to prevent the issuing bank from honoring a letter of credit when presented with a draft by a credit beneficiary. Plaintiff O'Grady, as guarantor of a note executed by a group of land developers to obtain a loan from First Union bank, caused a letter of credit to be issued by the Bank of North Carolina in favor of defendant First Union.⁴¹ The letter of credit conditioned the honor of drafts upon the presentation of a "[c]ertified and true photostatic copy of each instrument causing this establishment of credit to Thomas O'Grady to be called upon."⁴² First Union presented a draft for honor under the letter of credit and, in accordance with the stated condition, attached a note upon which the land developers had defaulted as evidence of O'Grady's guarantor liability.⁴³ In an action involving numerous other parties and claims, O'Grady brought suit to enjoin the issuing Bank of North Carolina from honoring the draft and to cancel the letter of credit.⁴⁴ O'Grady asserted that the attached note did not conform with the note that he had agreed to guarantee in that the note presented did not contain the signature of one of the principals O'Grady claimed had been present on the earlier draft of the instrument, and whose signature was a condition of the credit.⁴⁵ Therefore, O'Grady argued, he should be allowed to prevent honor of the draft.⁴⁶ Although the court of appeals affirmed the trial court's dismissal of plaintiff's suit, the supreme court reversed and remanded the case for further factual determination.⁴⁷

In reaching its decision the court assumed that the note presented as documentation of O'Grady's liability was, as O'Grady contended, materially different from the note that O'Grady had intended to guarantee.⁴⁸ The court acknowledged that under the provisions of article 5 of the Uniform Commercial Code, the issuer generally has a duty to

40. 296 N.C. 212, 250 S.E.2d 587 (1978).

41. *Id.* at 216, 250 S.E.2d at 591.

42. *Id.* at 229, 250 S.E.2d at 598-99.

43. *Id.* at 234, 250 S.E.2d at 602.

44. *Id.* at 215, 250 S.E.2d at 590-91.

45. *Id.* at 230, 250 S.E.2d at 593.

46. N.C. GEN. STAT. § 25-5-114(2)(b) (1965) expressly recognizes the power of a court of appropriate jurisdiction to enjoin the honor of a draft when one of the § 25-5-114(2) exceptions is shown. For a list of exceptions, see note 50 *infra*.

47. 296 N.C. at 217, 236, 250 S.E.2d at 592, 602.

48. 296 N.C. at 230, 250 S.E.2d at 599. Because the trial court failed to enter a finding of

honor drafts upon presentation by the beneficiary regardless of disputes that may exist between the beneficiary of the letter of credit and the issuing bank's customer, so long as conditions of credit are fulfilled.⁴⁹ G.S. 25-5-114(2), however, provides certain limited exceptions to the general rule regarding the stringent duty of honor,⁵⁰ and the supreme court sought to determine whether O'Grady's contentions, if proved, would allow him relief under that statute.

Citing extensive authority from other jurisdictions, the court held that "knowing and intentional attachment of a guaranty letter of credit, as collateral security, to a negotiable instrument which that letter was not intended to secure, and the eventual presentation of these documents to the issuing bank for purposes of honor of the letter of credit" constitutes presentation of "fraudulent documents" as contemplated by G.S. 25-5-114(2) and, given adequate proof of the contention, would allow the plaintiff to enjoin honor of the draft.⁵¹

The decision seems to comport with the interpretation of the majority of jurisdictions.⁵² Moreover, the court's opinion represents a cautious and proper balance of interests of the customer and beneficiary in the letter of credit scheme. The court's extensive discussion of the issuer's generally stringent duty to honor the letter of credit in spite of alleged infirmities in the underlying transaction reflects an important purpose of letters of credit, which is to eliminate the risk that the customer will refuse or halt payment because of alleged deficiencies in the beneficiary's performance.⁵³ On the other hand, the court, by recognizing the possibility of an injunction when the documents presented differ materially from the ones in the underlying transaction, properly acknowledged that the policy favoring stringent duty of honor will not be carried so far that it will promote fraud upon the customer.

facts on the issue the court was forced to assume O'Grady's factual contention in order to address the legal question.

49. N.C. GEN. STAT. § 25-5-114(1) (1965) provides: "An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary" See also *Courtaulds N. America, Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92 (M.D.N.C.), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975).

50. "These exceptions are: (1) the failure of certain documents to conform to certain specified warranties, (2) the presentment of forged or 'fraudulent' documents, and (3) 'fraud in the transaction.'" 296 N.C. at 232, 250 S.E.2d at 600 (construing N.C. GEN. STAT. § 25-5-114 (1965)).

51. *Id.* at 234-35, 250 S.E.2d at 601-02 (citing, e.g., *Dynamics Corp. of America v. Citizens & S. Nat'l Bank*, 356 F. Supp. 991 (N.D. Ga. 1973); *Marine Midland Grace Trust Co. v. Banco Del Pais, S.A.*, 261 F. Supp. 884 (S.D.N.Y. 1966)).

52. See, e.g., cases cited note 51 *supra*.

53. See J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 18-4, at 616 (1972).

3. Secured Transactions

a. Commercial Reasonableness in the Disposition of Collateral

A secured party, upon default, may dispose of collateral by public or private sale, but G.S. 25-9-504 provides that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."⁵⁴ When suing for a deficiency,⁵⁵ a creditor has the burden of proving the sale was conducted in a commercially reasonable manner.⁵⁶ If the creditor disposes of collateral at a public sale, the North Carolina version of the Uniform Commercial Code allows a creditor to prove compliance with the commercial reasonableness requirement by demonstrating that the sale was conducted in "substantial compliance" with the procedures contained in part 6 of article 9.⁵⁷ G.S. 25-9-601 provides that proof of "substantial compliance" with the public sale procedures in part 6 raises a conclusive presumption that the sale was commercially reasonable.⁵⁸ Failure to substantially comply with the procedures in part 6 in conducting a public sale of collateral does not preclude a finding that the sale was commercially reasonable,⁵⁹ but does deprive the secured party of the conclusive presumption and raises a question of fact whether the public sale was otherwise conducted in a commercially reasonable manner.⁶⁰ If the disposition of collateral is made in a private proceeding the sale must also be commercially reasonable, but the North Carolina version of the Code does not provide the creditor who disposes of his collateral by private sale a means of obtaining a conclusive presumption of commercial reasonableness.

Failure to demonstrate that a public or private sale of collateral was conducted in a commercially reasonable fashion, however, does not necessarily prevent a secured party from obtaining a deficiency

54. N.C. GEN. STAT. § 25-9-504(3) (Cum. Supp. 1977).

55. The Code provides: "If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency." *Id.* § 25-9-504(2).

56. *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 458, 229 S.E.2d 814, 820 (1976).

57. N.C. GEN. STAT. § 25-9-601 (Cum. Supp. 1977); *Graham v. Northwestern Bank*, 16 N.C. App. 287, 293, 192 S.E.2d 109, 113, *cert. denied*, 282 N.C. 426, 192 S.E.2d 836 (1972). The procedures, N.C. GEN. STAT. §§ 25-9-601 to -607 (Cum. Supp. 1977), are not part of the official text of the Uniform Commercial Code and are apparently peculiar to North Carolina. *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 457, 229 S.E.2d 814, 819 (1976).

58. N.C. GEN. STAT. § 25-9-601 (Cum. Supp. 1977).

59. *Hodges v. Norton*, 29 N.C. App. 193, 196-97, 223 S.E.2d 848, 850 (1976).

60. *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 457-58, 229 S.E.2d 814, 819-20 (1976).

judgment in North Carolina.⁶¹ As a remedy for a noncommercially reasonable sale, G.S. 25-9-507(1) merely allows the debtor to offset any deficiency judgment by the amount of damages the debtor has suffered as a result of the secured party's failure to dispose of collateral in a commercially reasonable manner.⁶² In establishing his claim the debtor has the benefit of a presumption that the "collateral was worth at least the amount of the debt" and the creditor must prove "market value of the collateral by evidence other than the resale price."⁶³

(i) Public Sale of Collateral

Several cases in 1978 presented the North Carolina courts with the opportunity to further clarify a secured party's duty to dispose of collateral in a commercially reasonable manner. Plaintiff creditor in *North Carolina National Bank v. Burnette*,⁶⁴ after a public sale of collateral,⁶⁵ brought suit to obtain a deficiency judgment. Defendant debtor's answer averred that the sale was not conducted in a commercially reasonable manner as required by G.S. 25-9-504.⁶⁶ The jury found for the debtor on the issue of commercial reasonableness and offset plaintiff's award by the total amount of the deficiency.⁶⁷ The trial court granted plaintiff's motion for judgment notwithstanding the verdict and defendant appealed.⁶⁸

Evidence presented at trial indicated that plaintiff posted and mailed notice of the sale within the time prescribed by G.S. 25-9-603,⁶⁹

61. *Hodges v. Norton*, 29 N.C. App. 193, 198, 223 S.E.2d 848, 851 (1976).

62. "[T]he debtor . . . has a right to recover from the secured party any loss by a failure to comply with the provisions of this part." N.C. GEN. STAT. § 25-9-507(1) (Cum. Supp. 1977).

63. *Hodges v. Norton*, 29 N.C. App. 193, 198-99, 223 S.E.2d 848, 851-52 (1976). See also *Associates Discount Corp. v. Cary*, 47 Misc. 2d 369, 262 N.Y.S.2d 646 (Civ. Ct. 1965).

64. 38 N.C. App. 120, 247 S.E.2d 648 (1978), cert. granted, 296 N.C. 410, 251 S.E.2d 468 (1979) (No. 116 PC).

65. Two separate sales were conducted. *Id.* at 121, 247 S.E.2d at 649-50. Plaintiff's conduct in the second sale, involving the disposition of some road grading equipment, was the focal point of the commercial reasonableness section of the court's opinion.

66. *Id.* at 122, 247 S.E.2d at 650.

67. *Id.*

68. *Id.* at 123, 247 S.E.2d at 650.

69. N.C. GEN. STAT. § 25-9-603 (Cum. Supp. 1977) provides:

Posting and mailing notice of sale—(1) In each public sale conducted hereunder, the notice of sale shall be posted on a bulletin board provided for the posting of such legal notices, in the courthouse, in the county in which the sale is to be held, for at least five days immediately preceding the sale.

(2) In addition to the posting of notice required by subsection (1), the secured party or other party holding such public sale shall, at least five days before the date of sale, mail by registered or certified mail a copy of the notice of sale to each debtor obligated under the security agreement:

but that the notice was mailed to the wrong address⁷⁰ and did not reach defendant until after the sale had been conducted.⁷¹ The court of appeals held that in light of this evidence the trial judge erred in granting plaintiff's judgment N.O.V. motion.⁷² Extending its decision in *ITT-Industrial Credit Co. v. Milo Concrete Co.*,⁷³ the court held that the creditor has the burden of proving that notice was properly sent to the debtor.⁷⁴ Because there was contradictory evidence concerning notice, the jury might reasonably have found that plaintiff creditor failed to meet the burden of adequate notice and therefore the court reasoned that granting the judgment N.O.V. was improper.⁷⁵ The court further stated that "the notice requirement under G.S. 25-9-603 is mandatory and is a distinct and separate requirement from the requirement for commercial reasonableness."⁷⁶ The court based its decision on the language employed in the various sections of part 6 of article 9. While G.S. 25-9-602, dealing with the contents of notice, mandates that notice "shall substantially" include certain items of information and G.S. 25-9-604 and 25-9-605 dealing with exceptions for perishable property and

(a) at the actual address of the debtors, if known to the secured party, or

(b) at the address, if any, furnished the secured party, in writing, by the debtors, or otherwise at the last known address.

(3) In the case of consumer goods, no other notification need be sent. In other cases, in addition to mailing a copy of the notice of sale to each debtor, the secured party shall also mail a copy of said notice by registered or certified mail to any other secured party from whom the secured party has received (before sending the notice of sale to the debtor(s)) written notice of a claim of an interest in the collateral.

70. The evidence indicated that the notice was sent to Route 1, Little Switzerland, North Carolina, even though a different address appeared on the security agreement, that notice of sale of other collateral securing the indebtedness had been sent to the correct address, and that plaintiff's agent responsible for sending the notice admitted that he knew there was no Route 1, Little Switzerland. 38 N.C. App. at 126, 247 S.E.2d at 652.

71. The notice for the sale scheduled for October 31, 1974, was mailed October 24, 1974, and did not reach defendants until November 7, 1974. *Id.* at 125-26, 247 S.E.2d 652.

72. *Id.* at 125, 247 S.E.2d at 652.

73. 31 N.C. App. 450, 229 S.E.2d 814 (1976). The *Milo* court held that a creditor, when suing for deficiency, has the burden of proving the sale was conducted in a commercially reasonable manner. *Id.* at 458, 229 S.E.2d at 820. For additional authority holding that the creditor also has the burden of proving that reasonable notice was sent to the debtor see *Universal C.I.T. Credit Co. v. Rone*, 248 Ark. 665, 669, 453 S.W.2d 37, 39 (1970).

74. 38 N.C. App. at 125, 247 S.E.2d at 651.

75. *Id.* The court noted that the test for determining the appropriateness of a judgment N.O.V. is the same as applied on a motion for directed verdict. *Id.* at 124, 247 S.E.2d at 651 (citing *Snelling v. Roberts*, 12 N.C. App. 476, 183 S.E.2d 872, *cert. denied*, 279 N.C. 727, 184 S.E.2d 886 (1971)). Because the North Carolina Supreme Court in *Cutts v. Casey*, 298 N.C. 390, 180 S.E.2d 297 (1971) held that the granting of a directed verdict in favor of the party with the burden of proof will be more closely scrutinized than for the party without the proof burden, the *Burnette* court considered it significant that plaintiff movant had the burden of proof on the issue of notice. 38 N.C. App. at 124, 247 S.E.2d at 651.

76. 38 N.C. App. at 127, 247 S.E.2d at 653.

postponement of public sale use the discretionary word "may,"⁷⁷ the court noted that G.S. 25-9-603 governing notice uses the unmodified word "shall" and should be interpreted as a separate and mandatory requirement.⁷⁸

While the court appears to have reached the correct result in the case,⁷⁹ its reasoning is troublesome. The *Burnette* court's reasoning that strict compliance with G.S. 25-9-603 is required for the purpose of the separate notice requirement because of the use of "mandatory" language in the section may also be used to support an argument that because G.S. 25-9-603 is contained in the provisions of part 6, strict compliance with this section is necessary to meet the substantial compliance test of G.S. 25-9-601 governing application of the statutory presumption of commercial reasonableness. Such a reading, however, would conflict with the statutory language and prior case law and would undermine the purpose of part 6.

Prior conflicting authority is found in *Wachovia Bank & Trust Co. v. Murphy*,⁸⁰ a case before the court of appeals earlier in 1978, in which the notice publication procedures of G.S. 25-9-603 were in issue. In *Murphy* plaintiff creditor brought suit to recover the deficiency remaining on the balance of defendants'⁸¹ indebtedness following the public disposition of collateral.⁸² At the close of all the evidence the trial judge directed a verdict for plaintiff in the amount prayed.⁸³ Defendant debtors appealed, alleging that the sale was not conducted in sub-

77. N.C. GEN. STAT. § 25-9-602, -604, -605 (Cum. Supp. 1977).

78. 38 N.C. App. at 127, 247 S.E.2d at 653. For text of § 25-9-603, see note 69 *supra*.

79. The court could have easily concluded that the evidence demonstrated as a matter of law that plaintiff creditor had not substantially complied with the mailing of notice requirement contained in § 25-9-603, could not benefit from the statutory presumption of commercial reasonableness provided by § 25-9-601, and therefore would be required to prove the sale was otherwise commercially reasonable, a burden that was not sustained by the evidence. See generally *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 229 S.E.2d 814 (1976). In *Hodges v. Norton*, 29 N.C. App. 193, 223 S.E.2d 848 (1976) the court of appeals held that when a creditor posts notice on the courthouse door but fails to send written notice to the debtor, the creditor has not substantially complied with the notice requirements of G.S. 25-9-603. *Id.* at 197, 223 S.E.2d at 850-51. It would not stretch the imagination to extend the holding in *Hodges* to a case like *Burnette* in which notice was sent to the wrong address and was not received by the debtor until after the sale.

80. 36 N.C. App. 760, 245 S.E.2d 101, *appeal dismissed, cert. denied*, 295 N.C. 557, 248 S.E.2d 734 (1978).

81. Three persons were liable for the debt. Donnie Murphy executed a note and security agreement to obtain funds for the purchase of a dump truck and as further condition for receipt of the loan he had his mother and father, Charles and Louise Murphy, sign the note and security agreement with him. *Id.* at 761, 245 S.E.2d at 102.

82. *Id.*

83. *Id.*

stantial compliance with part 6 and therefore plaintiff was not entitled to the conclusive presumption that the sale was commercially reasonable in all respects.⁸⁴ Defendants' only claim was that the creditor failed to comply with the requirement that notice of sale be mailed to "each debtor obligated under the security agreement."⁸⁵ Defendants' evidence showed that notice was mailed to two of the debtors collectively at their common address and that the return receipt was signed by only one of them.⁸⁶ The court of appeals, speaking through Chief Judge Brock, concluded that while "the better practice would be for the secured party to make separate mailings of notice to each debtor . . . the mailing of a joint notice to husband and wife at the residence address where they both lived was substantial compliance within the meaning of G.S. 25-9-601."⁸⁷ Thus, while the court did not specifically state that substantial compliance with G.S. 25-9-603—and the other provisions of part 6—is all that is necessary to obtain the statutory presumption of commercial reasonableness, such a conclusion is clearly to be implied from the court's language.⁸⁸

Additional support for the argument that strict compliance with the notice procedures of G.S. 25-9-603 is not required for a secured party to benefit from the conclusive presumption of commercial reasonableness is found in the language of G.S. 25-9-601. While it is true that G.S. 25-9-603 contains mandatory language unmodified by any phrase contained in the section, the mandate must be read in conjunction with the prefatory provision of G.S. 25-9-601 that modifies the remainder of part 6 with language indicating that substantial compliance with each provision is all that is necessary for purposes of the statutory presumption. Thus, in light of the plain language of G.S. 25-9-601 and the implicit conclusions derived from *Murphy*, *Burnette* should not be interpreted as requiring strict compliance with procedures of G.S. 25-9-

84. Defendants also challenged the constitutionality of § 25-9-601 on the ground that it violates the due process clause of the fourteenth amendment. *Id.* The court pointed to the protection provided the debtor through the notice requirements and concluded that the procedures comport with due process. *Id.* at 762-63, 245 S.E.2d at 103.

85. N.C. GEN. STAT. § 25-9-603(2) (Cum. Supp. 1977) (emphasis added).

86. The return receipt was signed for debtor Charles Murphy by his mother but it was not signed by or for Murphy's wife Louise. 36 N.C. App. at 764, 245 S.E.2d at 104.

87. *Id.*

88. The same conclusion can be drawn from the court's language in *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 229 S.E.2d 814 (1976). Although the court in *Milo* thought the evidence presented was insufficient to establish that the secured party had substantially complied with the requirements of §§ 25-9-602, -603, the court's language suggests that only substantial compliance with the procedures of § 25-9-603 and with the other sections of part 6 is required to give rise to the presumption of commercial reasonableness. *Id.* at 457, 229 S.E.2d at 819.

603 before a secured party can benefit from the conclusive presumption of commercial reasonableness in a public sale.⁸⁹

(ii) Private Sale of Collateral

The court of appeals faced a question of commercial reasonableness in a case involving a private sale of collateral in *Allis-Chalmers Corp. v. Davis*.⁹⁰ Plaintiff creditor brought an action to recover a deficiency. Defendant debtors denied deficiency liability and counterclaimed for damages under G.S. 25-9-507, alleging that the secured party did not sell in a commercially reasonable manner as required by G.S. 25-9-504.⁹¹ Choosing not to contest the commercial reasonableness of the method, manner or time of the disposition, defendants argued solely that the secured party had accepted an unreasonably low price for the collateral.⁹² At the close of all the evidence, the trial court granted plaintiff's motion for a directed verdict on its deficiency claim and on defendant's counterclaim; defendants appealed.⁹³

Ruling that price is one of the "terms" of sale falling under the commercial reasonableness requirement of G.S. 25-9-504(3),⁹⁴ the court of appeals held that when a private sale is otherwise commercially reasonable the price received for the collateral is presumed to be commercially reasonable,⁹⁵ but when the debtor offers independent evidence of a "gross inadequacy in price"⁹⁶ a question of commercial rea-

89. In most cases, however, a creditor will probably have to present evidence of notice that approaches strict compliance or its functional equivalent before a court will find that the creditor is entitled to the statutory presumption.

90. 37 N.C. App. 114, 245 S.E.2d 566 (1978).

91. *Id.* at 116, 245 S.E.2d at 568.

92. *Id.* at 117, 245 S.E.2d at 569.

93. *Id.* at 116, 245 S.E.2d at 568.

94. *Id.* at 117, 245 S.E.2d at 569. This is apparently the first time a North Carolina court has held that price is one of the terms of sale that must be commercially reasonable pursuant to the provisions of N.C. GEN. STAT. § 25-9-504 (Cum. Supp. 1977). This interpretation seems to be accepted in most other jurisdictions. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11, at 986; *see, e.g.*, *Associates Fin. Co. v. Teske*, 190 Neb. 747, 212 N.W.2d 572 (1973).

95. 37 N.C. App. at 119, 245 S.E.2d at 570. The court cited Community Management Ass'n, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973). The *Tousley* court held that when value is in issue there is an initial presumption that collateral has the same value as the outstanding debt, but that when the creditor demonstrates that the sale was otherwise commercially reasonable a presumption arises that the price received was the fair market value of the collateral. *Id.* at 36, 505 P.2d at 1316-17.

96. The collateral, an Allis-Chalmers 615 loader and backhoe, was purchased subject to the security agreement in October 1972 for \$14,971.32. When the collateral was repossessed in September 1974 a balance of \$6,282.64 was owed on the debt. The collateral was sold at wholesale to Godley Auction Co. for \$3,500 in April 1975. Defendants presented the following evidence to support their claim that the price accepted by plaintiff was unreasonably low: (a) testimony by defendant Davis that in his opinion the machine had a fair market value of \$8,500; (b) testimony

sonableness sufficient to avoid a directed verdict is raised.⁹⁷ The court rejected plaintiff's argument that various provisions found in G.S. 25-9-507(2) preclude an inquiry into the commercial reasonableness of price.⁹⁸ First, the court ruled that the language in the section that provides "[t]he fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner"⁹⁹ does not give the secured party "unbridled discretion" in the price that is accepted for the collateral.¹⁰⁰ While the opinion suggests that a price that is "slightly inadequate" might be protected, G.S. 25-9-507(2) will not serve to bar examination of the commercial reasonableness of the resale price when the debtor presents evidence that might lead a jury to conclude that the price accepted was "grossly inadequate."¹⁰¹ Second, the court ruled that the language of G.S. 25-9-507(2), which states that if a secured party "has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner,"¹⁰² offered no benefit to the creditor since a sale for a commercially unreasonable price does not conform with "reasonable commercial practices among dealers."¹⁰³

While not specifically mentioned in the court's opinion, the holding in the recent case of *First Union National Bank v. Tectamar, Inc.*¹⁰⁴ is clarified by *Allis-Chalmers*. Defendant debtor in *Tectamar*, like defendant in *Allis-Chalmers*, argued that plaintiff accepted an unreasona-

by Michael Duckett, a disinterested witness, that he saw a similar backhoe (which he believed to be the machine in question) on the lot of Godley Auction Co. and that Godley was asking \$6,500 for the machine; and (c) testimony by Duckett that he believed the value of the backhoe to be between \$6,500 and \$7,000 in that area of the state in April 1975. 37 N.C. App. at 115-16, 245 S.E.2d at 568.

97. *Id.* at 117-18, 245 S.E.2d at 569. The court, extending the application of its reasoning in *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 229 S.E.2d 814 (1976), noted that the creditor has the burden of proving that the price was commercially reasonable in order to fulfill the mandate of § 25-9-504(3). The court's language seems to suggest that this burden is fulfilled in a private sale situation when the creditor offers proof that the sale was otherwise commercially reasonable; when the debtor offers evidence of a gross inadequacy in price, however, the presumption is rebutted and the burden must be fulfilled by independent evidence that the price was reasonable.

98. N.C. GEN. STAT. § 25-9-507(2) (Cum. Supp. 1977).

99. *Id.*

100. 37 N.C. App. at 118, 245 S.E.2d at 569.

101. *Id.*

102. N.C. GEN. STAT. § 25-9-507(2) (Cum. Supp. 1977).

103. 37 N.C. App. at 118, 245 S.E.2d at 570.

104. 33 N.C. App. 604, 235 S.E.2d 894 (1977).

bly low price for the collateral at a private sale.¹⁰⁵ The court of appeals refused to reverse on the basis of this argument the trial court's grant of summary judgment for plaintiff.¹⁰⁶ Citing G.S. 25-9-507(2), the court held that defendant's evidence concerning price when combined with the lack of evidence disputing the commercial reasonableness of any other aspect of the sale was insufficient to raise a genuine issue of material fact.¹⁰⁷ It was unclear whether the court meant by this holding to exclude all inquiries into the inadequacy of price in cases in which no other aspect of the private sale is challenged.¹⁰⁸ *Allis-Chalmers* makes clear that when evidence of a "gross inadequacy" in price is presented, neither the provisions of G.S. 25-9-507(2) nor an absence of dispute concerning the commercial reasonableness of any other aspect of the private disposition preclude a debtor from reaching the jury on the issue of commercial reasonableness of the sale.

The opinion in *Allis-Chalmers* seems consistent with the need to provide greater protection to debtors in deficiency suits when the collateral has been disposed of in a private sale. If the secured party in a public sale situation follows the requirements in part 6, the debtor and the market are adequately informed and the debtor can protect his interest in seeing that the collateral reaps as high a price as possible by "paying the debt, finding a buyer, or being present at the sale to bid."¹⁰⁹ The debtor in a private sale situation, on the other hand, must rely more heavily upon the selling efforts of the secured party. The commercial realities of the private sale, therefore, demand that the debtor be given the protection of contesting the adequacy of the price when the debtor's evidence suggests the need for such an inquiry even if other aspects of the sale are uncontested. This reasoning suggests that the holding in *Allis-Chalmers* should be applied to the public sale situation when the secured party fails to show substantial compliance with the procedures in part 6.¹¹⁰

105. *Id.* at 604-05, 235 S.E.2d at 895.

106. The judgment of the lower court was reversed on other grounds. *Id.* at 606-07, 235 S.E.2d at 896.

107. *Id.* at 606, 235 S.E.2d at 896.

108. It seems that the court may simply have been unpersuaded by the quality of defendant's evidence, which consisted principally of the rebutted testimony of an arguably interested witness. *See id.* at 604-06, 235 S.E.2d at 895-96.

109. *Hodges v. Norton*, 29 N.C. App. 193, 197, 223 S.E.2d 848, 850 (1976).

110. If a creditor is able to show that a public sale was conducted in substantial compliance with the procedures in part 6 the conclusive presumption of commercial reasonableness provided in § 25-9-601 will preclude any inquiry into the commercial reasonableness of the resale price, although the procedures in part 6 are not designed to govern directly the price accepted. *Graham v. Northwestern Bank*, 16 N.C. App. 287, 293, 192 S.E.2d 109, 113, *cert. denied*, 282 N.C. 426, 192

Although the decision in *Allis-Chalmers* was well reasoned, several questions regarding the application of the holding to future cases remain unanswered. First, the court failed to define what considerations should be employed in determining whether a price is "grossly inadequate." Such a concept is difficult to define, however, and trial judges should be given the discretion to apply equitable judgment according to the facts of each case.¹¹¹ Second, the court did not specify whether the resale price should be judged against evidence of the retail or wholesale market value of the collateral. Some authority suggests that the comparison should vary depending upon whether the creditor has the facilities to reach the retail or wholesale market with the least marketing and administrative costs.¹¹² Finally, it is unclear what sort of evidence will satisfy the debtor's burden of production. There is authority to support the acceptance of three types of evidence: expert testimony,¹¹³ market guidebooks,¹¹⁴ and evidence of a second resale price.¹¹⁵

b. Statute of Limitations Applicable to Security Agreements Under Seal

In *North Carolina National Bank v. Holshouser*,¹¹⁶ the North Carolina Court of Appeals addressed the question of which statute of limita-

S.E.2d 836 (1972). If a secured party does not substantially comply with those procedures no conclusive presumption is raised and the commercial reasonableness of the sale must be proven. *ITT-Industrial Credit Co. v. Milo Concrete Co.*, 31 N.C. App. 450, 457-58, 229 S.E.2d 814, 819-20 (1976). A debtor in such a situation should have the same right to question the commercial reasonableness of the price as he would if the collateral were sold in a private proceeding.

111. There is authority that suggests that in deciding whether a resale price is unreasonably low, the trial court should examine evidence concerning the creditor's good faith and the extent of the creditor's efforts in disposing of the collateral. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11, at 991. Interestingly, the court of appeals in *Allis-Chalmers* seemed unpersuaded by the creditor's extensive efforts to locate a buyer for the collateral. See 37 N.C. App. at 115-16, 245 S.E.2d at 568, and Record at 20 (testimony of James M. Dixon, Central Credit Manager for Allis-Chalmers Credit Corp.).

112. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11, at 990-91. Although the retail market will normally yield the higher price, creditor efforts should not be judged against an estimated retail market value if it appears that the marginal gains of entering the retail market are outweighed by the creditor's administrative costs incurred in entering this market.

113. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11, at 989. Proof by expert testimony may have been presented in *Allis-Chalmers*. Although it is unclear from the opinion, the testimony of Michael Duckett, see note 96 *supra*, may have qualified as expert testimony.

114. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11; see, e.g., *Atlas Constr. Co. v. Dravo-Doyle Co.*, 3 U.C.C. Rep. Serv. 124 (Pa. C.P. 1965). This type of evidence may have limited application, however, since many markets lack such guidebooks and the guidebooks are usually incapable of adjusting price according to the condition of the collateral.

115. J. WHITE & R. SUMMERS, *supra* note 53, § 26-11, at 989.

116. 38 N.C. App. 165, 247 S.E.2d 645 (1978).

tions applies to a deficiency action brought after the repossession and sale of collateral by the holder of a purchase money security agreement under seal. Plaintiff, assignee of a purchase money security agreement executed under seal by defendant for the purchase of an automobile, brought this deficiency action a little more than four years after the collateral was repossessed and disposed of by public sale.¹¹⁷ The trial court granted judgment on the pleadings for defendant on the ground that the action was barred by the four year statute of limitations applicable in actions for breach of any contract of sale contained in article 2 of the Uniform Commercial Code.¹¹⁸ On appeal plaintiff contended that the four year statute of limitations is inapplicable to deficiency actions brought pursuant to a security agreement governed by article 9.¹¹⁹ Since the action was brought on a sealed security instrument plaintiff averred that the ten year limitations period for actions on sealed instruments provided by G.S. 1-47¹²⁰ governed and, therefore, the suit was timely.¹²¹

A majority of the court of appeals agreed with plaintiff and reversed the trial court's judgment. The court based its decision on "the plain language of Article 2" and certain legislative action pertinent to G.S. 1-47.¹²² Acknowledging that the purchase money security agreement executed by defendant acted as both a sales contract and a security instrument, the court held that the language in G.S. 25-2-102¹²³ and

117. *Id.* at 165-66, 247 S.E.2d at 645. The purchase money security agreement was executed on June 25, 1970. Defendant defaulted immediately and the automobile was repossessed. The vehicle was sold by public sale on September 28, 1970 but the deficiency suit was not filed until November 1, 1974. *Id.*

118. *Id.* at 166, 247 S.E.2d at 645, citing N.C. GEN. STAT. § 25-2-725(1) (1965) ("An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued.").

119. Article 9 of the Uniform Commercial Code covers secured transactions.

120. The statute only governs actions against the *principal* obligees on a sealed instrument. N.C. GEN. STAT. § 1-47 (1969) provides:

Ten Years—Within ten years an action—

(2) Upon a sealed instrument against the principal thereto. Provided, however, that if action on a sealed instrument is filed, the defendant or defendants in such action may file a counterclaim arising out of the same transaction or transactions as are the subject of plaintiff's claim, although a shorter statute of limitations would otherwise apply to defendant's counterclaim.

121. 38 N.C. App. at 166, 247 S.E.2d at 645.

122. *Id.* at 171, 247 S.E.2d at 648.

123. The statute provides:

Scope: certain security and other transactions excluded from this article.—Unless the context otherwise requires, this article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this article

its related comments¹²⁴ defining the scope of provisions contained in article 2 indicates that the provisions of article 2 govern the pure sales aspects and the provisions of article 9 govern the security aspects of the transaction.¹²⁵ Since the deficiency action was brought on the security agreement pursuant to rights provided in article 9,¹²⁶ the court reasoned that G.S. 25-2-725, the four year statute of limitations found in article 2, was inapplicable.¹²⁷ Because article 9 contains no limitations provision the court looked to prior law and determined that the ten year limitations period for actions on sealed instruments provided by G.S. 1-47(2) governed the suit.¹²⁸

In addition to analysis of the statutory language the court of appeals noted that in 1969 the legislature amended G.S. 1-47¹²⁹ to allow principals sued on sealed instruments to assert claims or defenses they might have by joinder of third parties even though the applicable statutes of limitations may otherwise have barred such third party claims. The court argued that the amendment was enacted to ameliorate the "potential for harsh results in the situation where a financial institution could wait to sue for deficiency after repossession and sale of collateral security until *after* the buyer's rights of action against sellers for any breach of warranty were barred" and was indicative of legislative acknowledgement that the ten year statute was to apply to actions on

impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

N.C. GEN. STAT. § 25-2-102 (1965).

124. The Official Comment states: "The Article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. . . ." *Id.*, Official Comment.

The North Carolina Comment provides further clarification: "This section sets out the scope of the Code, limiting it to transactions in goods . . . and indicates that the article on sale does not apply to transactions intended as security even though in the form of an unconditional contract of sale or to sell . . ." *Id.*, North Carolina Comment.

125. 38 N.C. App. at 169, 247 S.E.2d at 647. Furthermore, the court noted that the "four year limitation of actions found in G.S. § 25-2-725(1) applies on its face only to actions for breach of any contract for sale." *Id.* (construing N.C. GEN. STAT. § 25-2-725(1) (Cum. Supp. 1977)).

126. N.C. GEN. STAT. § 25-9-504(1) (Cum. Supp. 1977) provides for the right to bring a deficiency action.

127. 38 N.C. App. at 169, 247 S.E.2d at 647 (citing N.C. GEN. STAT. § 25-2-725 (Cum. Supp. 1977)). In addition the court noted that the provision of "G.S. § 25-2-203, which makes seals of no effect on contracts for sale, is similarly limited in its effects to the pure sales aspects of the transactions, and is not relevant to purchase money security agreements . . . regulated by Article 9 generally." *Id.* (construing N.C. GEN. STAT. § 25-2-203 (1965)).

128. *Id.*

129. Law of June 11, 1969, ch. 810, § 1, 1969 N.C. Sess. Laws 862. Although the language of § 1-47(2) allows such defendants in sealed instrument actions to file counterclaims that might otherwise be untimely, the court apparently interpreted the statute as also saving third-party claims. 38 N.C. App. at 170, 247 S.E.2d at 647.

purchase money security agreements under seal.¹³⁰

Although a strict reading of the language of the Code and comments may provide support for the holding in *Holshouser*, the result seems unduly harsh to the consumer-debtor and persuasive argument for a contrary holding can be found. First, the opinion ignores the essential similarities of deficiency suits to suits for breach of contract for sale and, therefore, creates a potential for inconsistent statute of limitations treatment for very similar actions. A deficiency suit is an in personam action for the excess of the debtor's obligation unpaid after the sale of collateral, an action to enforce the buyer's obligation to pay the full sale price. Thus at least one court has concluded on this sparsely litigated question that a deficiency action is more closely related to the sales aspect of a combination sales-security agreement than to its security aspect and should be controlled by the four year limitations period.¹³¹ If a seller, holding a combination sales-security instrument ignored the security and brought an action for the unpaid price, the four year limitations period would surely apply.¹³² It seems inconsistent to hold, as the court in *Holshouser* did, that if the buyer pursued a similar remedy by bringing a deficiency action under the security agreement affixed with a seal that he would have the benefit of a ten year limitations period.

Second, the court's conclusion that the amendment to G.S. 1-47 is indicative of legislative approval of the application of the ten year statute of limitations period to deficiency actions on sealed purchase money security agreements is questionable. A deficiency action on a sealed purchase money security agreement is not the only situation in

130. 38 N.C. App. at 170, 247 S.E.2d at 647.

131. *Associates Discount Corp. v. Palmer*, 47 N.J. 183, 187-88, 219 A.2d 858, 861 (1966) (applying Pennsylvania law). The court in *Holshouser* rejected the analysis of the New Jersey Supreme Court and distinguished the *Palmer* holding on the ground that the Pennsylvania legislature expressed an intention in the comments to § 2-102 to have article 2 govern all aspects of a combination sales-security instrument. 38 N.C. App. at 170-71, 247 S.E.2d at 648. The language cited by the court, however, does not clearly indicate a contrary intent to that expressed in the North Carolina Comment, note 124 *supra*. The Pennsylvania Comment does not specifically state, as the court of appeals seems to believe, that all aspects of a combination agreement are to be governed in Pennsylvania by article 2; if read as consistent with the Official Comment, note 124 *supra*, it provides that the sales aspects of such an instrument are subject to article 2 and the secured transactions aspects are subject to article 9. Therefore, the argument made by the court in *Palmer* that a deficiency suit is more closely akin to the sales aspects of the instrument and should be subject to the four year limitations period cannot be disregarded as being unique to the Pennsylvania legislature's intent and inconsistent with the North Carolina Comment. Indeed, the North Carolina Comment does not preclude a court from reaching the conclusion of the *Palmer* court based on a recognition of the essential nature of a deficiency suit.

132. *Associate Discount Corp. v. Palmer*, 47 N.J. 183, 193, 219 A.2d 858, 864 (1966) (Hall, J., concurring).

which the amendment could provide protection,¹³³ and, therefore, without more, the amendment should not be viewed as an indication of legislative support for the application of a ten year statute of limitations to such situations. Moreover, while the amendment would certainly grant some protection to the debtor from the potential harsh results of the ten year statute of limitations,¹³⁴ other interests favoring application of a shorter limitations period, such as preservation of witness memories, are unaffected by the legislation. It appears that the holding in *Holshouser* is based on a questionable interpretation of statutory language and legislative intent and, therefore, could be subject to further scrutiny in future litigation.

B. Contracts

1. Relationship of Contract and Tort

In *North Carolina State Ports Authority v. Fry Roofing Co.*¹³⁵ the North Carolina Supreme Court addressed the troublesome question of when a breach of contract may also be a tort. The court rejected the holding of the court of appeals¹³⁶ that a promisee's allegation of breach of contract against the promisor may also support an action in tort whenever the breach is negligent. In disallowing the action in tort the supreme court distinguished prior cases holding a promisor liable in tort for the negligent performance of his contract as involving more than the simple failure to discharge a contractual obligation.¹³⁷

Plaintiff in *Ports Authority* contracted with Dickerson, Incorporated, a general contractor, to construct a shed and warehouse. Four years after the buildings were completed and delivered to plaintiff, the roofs began to leak.¹³⁸ Plaintiff sued Dickerson for breach of the building contract and in tort for its negligent performance—the failure to exercise reasonable care in supervising the installation of the roofs—

133. For example, it would apply to actions brought in connection with real property sealed deeds of trust. See *Serls v. Gibbs*, 205 N.C. 246, 171 S.E. 56 (1933).

134. See text accompanying note 129 *supra*.

135. 294 N.C. 73, 240 S.E.2d 345 (1978).

136. 32 N.C. App. 400, 232 S.E.2d 846 (1977), *aff'd on other grounds*, 294 N.C. 73, 240 S.E.2d 345 (1978). "Appellant petitioned [the supreme court] for review of [the court of appeals'] judgment 'in part and only as to that Court's reversal of the Trial Court judgment dismissing Plaintiff's action in tort as to the Defendant Dickerson.'" 294 N.C. at 86, 240 S.E.2d at 353. The supreme court concluded that the appeals court had reached the right result but was wrong in holding that the complaint alleged an action in tort. *Id.* at 83, 86, 240 S.E.2d at 350, 352.

137. 294 N.C. at 81-82, 240 S.E.2d at 350.

138. *Id.* at 75, 240 S.E.2d at 347.

and sought to recover the cost of repairing the roof.¹³⁹ The court held that in cases in which defendant promisor contracts to construct buildings, including roofs, in accordance with certain plans and specifications, and plaintiff alleges that defendant did not so construct the roofs, the only injury suffered is a loss of the benefit of the promised performance, which is purely contractual in nature.¹⁴⁰ In other words, because there was no extra-contractual duty, common law or otherwise, to do the thing agreed to be done, it was immaterial that the breach was due to negligence.

The *Ports Authority* rule, simply stated, is that a suit should proceed for all substantive and procedural purposes on a contract theory when it appears from the facts set out in the complaint and the prayer for relief that the plaintiff is suing for loss of the benefit of his bargain.¹⁴¹ The distinction between contract related injuries that can support an action in tort for the violation of a common law duty of due care and those that cannot is thus based on the nature of the injury as characterized by the particular facts alleged.¹⁴²

The *Ports Authority* tort preclusion rule is sound for several reasons. As a matter of substantive law, it seems only fair that a plaintiff should not be permitted to transform a breach of contract action into

139. *Id.* at 75, 240 S.E.2d at 346.

140. *Id.* at 83, 240 S.E.2d at 351.

141. The court rejected plaintiff's argument that, regardless of the existence of a contract, Dickerson had committed the tort of misfeasance by failing to exercise reasonable care in the construction of the buildings, *see* Brief for Plaintiff Appellee at 11, and thus declined to follow the traditional nonfeasance-misfeasance doctrine for determining when a tort remedy is cumulative. *See* Prosser, *The Borderland of Tort and Contract*, in *SELECTED TOPICS ON THE LAW OF TORTS* 380 (1954). Consequently, the rule that "accompanying every contract is a common-law duty to perform with ordinary care the thing agreed to be done," *Pinnix v. Toomey*, 242 N.C. 358, 362, 87 S.E.2d 893, 898 (1955), was inapplicable in *Ports Authority*. 294 N.C. at 81-83, 240 S.E.2d at 350-51.

142. The court explained, 294 N.C. at 82, 240 S.E.2d at 350-51, that the cases constituting exceptions to the general rule that an injury arising out of the performance of a contract does not constitute a tort fall into four categories: (1) The injury so caused was to the person or property of a third party. *See generally* *Pinnix v. Toomey*, 242 N.C. 358, 87 S.E.2d 893 (1955); *Council v. Dickerson's, Inc.*, 233 N.C. 472, 64 S.E.2d 551 (1951). (2) The injury so caused was to the property of the promisee other than the property that was the subject of the contract, or was a personal injury to the promisee. *See generally* *Firemen's Mut. Ins. Co. v. High Point Sprinkler Co.*, 266 N.C. 134, 146 S.E.2d 53 (1966); *Jewell v. Price*, 264 N.C. 459, 142 S.E.2d 1 (1965); *Toone v. Adams*, 262 N.C. 403, 137 S.E.2d 132 (1964); *Shearin v. Lloyd*, 246 N.C. 363, 98 S.E.2d 508 (1957). (3) The injury consisted of loss or damage to the promisee's property, which was the subject of the contract, and the promisor was charged by law, as a matter of public policy, with the duty to use care in the safeguarding of the property from harm, as in the case of a common carrier, an innkeeper or other bailee. *See generally* *Miller's Mut. Fire Ins. Ass'n v. Parker*, 234 N.C. 20, 65 S.E.2d 341 (1951). (4) The injury so caused was a wilful injury to or conversion of the property of the promisee, which was the subject of the contract, by the promisor. *See generally* *Williamson v. Dickens*, 27 N.C. (5 Ired.) 259 (1844); *Simmons v. Sikes*, 24 N.C. (2 Ired.) 98 (1841).

an action in tort and thereby avail himself of such advantages as a more liberal measure of damages or a more favorable standard of liability. Second, because many procedural and substantive issues such as conflict of laws, jurisdiction, limitations, and survival of actions turn on whether the plaintiff has in fact brought his suit in contract or tort, confining the plaintiff to one theory of recovery at the outset of the litigation facilitates efficient suit administration. Moreover, such an approach is consistent with the conceptual distinction between contract and tort that has evolved from the divergence of the action of assumpsit from trespass on the case.¹⁴³

In *CF Industries v. Transcontinental Gas Pipe Line Corp.*¹⁴⁴ the United States District Court for the Western District of North Carolina confronted a slightly different version of the *Ports Authority* question—whether a third party may sue in tort on a negligent performance of contract theory to recover profits lost because of the promisor's failure to discharge a contractual obligation. Defendant Transcontinental Gas Pipe Line Corporation (Transco), a wholesale supplier of natural gas, failed to fully deliver on its contract to supply gas to a retail distributor.¹⁴⁵ CF Industries (CFI), a customer of the retail distributor, suffered production curtailments as a result of inadequate gas supplies, and sued Transco in tort for negligence as well as in contract as a third-party beneficiary.¹⁴⁶ The district court denied Transco's motion for summary judgment on both claims and held not only that as an intended third-party beneficiary CFI could maintain an action in tort for negligence,¹⁴⁷ but that CFI's allegations that Transco undertook to per-

143. See generally T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 284 (5th ed. 1956).

144. 448 F. Supp. 475 (W.D.N.C. 1978). For discussion of the facts of the case, see notes 157-163 and accompanying text *infra*.

145. *Id.* at 479.

146. *Id.* at 477.

147. The cases involving suits by a third party against a promisor for breach of contract or its negligent performance have not provided a consistent rule of decision concerning the question whether the third party may sue in contract or tort. The following rules espoused in the North Carolina cases, although not necessarily inconsistent, suggest some of the uncertainty surrounding third party rights: (1) A qualified third-party beneficiary of a contract may sue in contract for its simple breach. See *Gorrell v. Greensboro Water Supply Co.*, 124 N.C. 328, 32 S.E. 720 (1899). (2) A qualified third-party beneficiary of a contract may sue in tort for negligence as well as in contract for breach. See generally *Toone v. Adams*, 262 N.C. 403, 137 S.E.2d 132 (1964). (3) A qualified third-party beneficiary may sue in contract, but only if the breach was due to negligence. See *Potter v. Carolina Water Co.*, 253 N.C. 112, 116 S.E.2d 374 (1960). (4) A third party may maintain an action in tort for negligence against a promisor irrespective of its status as a qualified third-party beneficiary. See *Pinnix v. Toomey*, 242 N.C. 358, 87 S.E.2d 893 (1955); *Jones v. Otis Elevator Co.*, 234 N.C. 512, 67 S.E.2d 492 (1951); *Council v. Dickerson's, Inc.*, 233 N.C. 472, 64 S.E.2d 551 (1951).

form the contract and performed negligently, resulting in foreseeable injury to CFI, stated a tort claim independent of third-party beneficiary status.¹⁴⁸

The *CF Industries* holding that a third party injured by the negligent performance of a contract may sue the promisor in tort is significant in two respects. Aside from the fact that plaintiff in *CF Industries* was not a party to the contract, the case is virtually indistinguishable from *Ports Authority*—the injury alleged was the loss of the benefit of Transco's promise to supply gas.¹⁴⁹ The cases relied upon by the district court that had permitted a third party to maintain a tort action for the negligent performance of a contract¹⁵⁰ were not inconsistent with the *Ports Authority* tort preclusion rule, because those cases involved injury to person or property outside the scope of the contract. Thus, under the *Ports Authority* refinement, the district court holding that a qualified third-party beneficiary could sue in tort for an injury arising out of the promisor's negligent failure to discharge a contractual obligation was error.

Second, *CF Industries* is the first case to permit a plaintiff not a party to a contract to sue on a negligence theory for the recovery of a pure economic loss—lost profits.¹⁵¹ The North Carolina cases finding liability for negligence in the absence of privity of contract and independent of any third-party beneficiary relationship have been limited to actions for personal injury or property damage.¹⁵² Although there were no cases prior to *CF Industries* that had barred such a claim, a subsequent case has cast doubt on the precedential value of the district court decision. In *McKinney Drilling Co. v. Nello L. Teer Co.*,¹⁵³ the

148. 448 F. Supp. at 483.

149. Nothing in *Ports Authority* suggested that the rule of that case should not be equally applicable to suits by third parties.

150. *Council v. Dickerson's, Inc.*, 233 N.C. 472, 64 S.E.2d 551 (1951), involved an action brought by an automobile driver against a highway contractor for personal injuries and property damage caused by the contractor's failure to adequately warn the motorist of its paving activity. In *Pinnix v. Toomey*, 242 N.C. 358, 87 S.E.2d 893 (1955), another case relied upon by the court, a building contractor sought damages against a plumbing contractor who had negligently performed a contract with the Mecklenberg Board of Education resulting in water damage to plaintiff's building under construction. Thus, unlike *CF Industries*, these cases involved more than an injury consisting of the loss of the benefit of the promised performance, but rather an injury to person and property beyond the scope of the contract.

151. Economic loss as opposed to personal injury or property damage may be defined as a pecuniary loss consisting of one or both of the loss of bargain (the difference between what one has paid and the actual value of what has been received), and the consequential loss of profits.

152. See *McKinney Drilling Co. v. Nello L. Teer Co.*, 38 N.C. App. 472, 476, 248 S.E.2d 444, 447 (1978).

153. 38 N.C. App. 472, 248 S.E.2d 444 (1978).

North Carolina Court of Appeals upheld dismissal of a subcontractor's claim against a consulting engineer for damages caused by a negligent inspection and said that "we have been cited to no North Carolina decisions and have found none allowing for loss of profits to a third party injured from the negligent breach of contract."¹⁵⁴ The district court's extension in *CF Industries* of the liability of a promisor to a third party for foreseeable economic loss not connected with personal injury or property damage was questionable under the *Erie*¹⁵⁵ mandate in light of the North Carolina courts' historical reluctance to discard the privity requirement.¹⁵⁶

2. Third-Party Rights

In *CF Industries v. Transcontinental Gas Pipe Line Corp.*,¹⁵⁷ the District Court for the Western District of North Carolina adopted the *Restatement (Second) of Contracts* standard¹⁵⁸ for the determination of when a third party may maintain an action for breach of contract. Plaintiff built a fertilizer plant¹⁵⁹ in northeastern North Carolina after securing assurances from defendant Transcontinental Gas Pipe Line Corporation (Transco), a major interstate gas transmission company, that the plant's natural gas requirements would be satisfied.¹⁶⁰ Because of Transco's policy of not competing with intrastate retail distributors,¹⁶¹ North Carolina Natural Gas (NCNG) was procured to serve as intermediary.¹⁶² Transco sold gas under contract to NCNG who in

154. *Id.* at 476, 248 S.E.2d at 447.

155. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

156. See Hodge, *Products Liability: The State of the Law in North Carolina*, 8 WAKE FOREST L. REV. 481 (1972).

157. 448 F. Supp. 475 (W.D.N.C. 1978).

158. RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tent. Drafts Nos. 1-7, 1973).

159. In 1973, Farmer's Chemical Association, Inc. (FCA), an agricultural cooperative corporation and owner of the plant, turned the management of the operation over to CF Industries, Inc. (CFI). In 1976 the agreement was transformed into a lease in which FCA assigned to CFI all its rights under the gas contract with North Carolina Natural Gas (NCNG). FCA and CFI, as co-plaintiffs, brought this diversity action against Transcontinental Gas Pipe Line Corporation (Transco) on May 18, 1977. 448 F. Supp. at 477 & n.1.

160. *Id.* at 478-79. FCA constructed the plant in 1969 in Tunis, North Carolina, after four years of investigation and study. Because the manufacture of nitrogen-based fertilizer requires large quantities of natural gas as a raw material, FCA's primary concern was to locate in an area where it could obtain an uninterruptible natural gas supply. Transco actively sought the location of the plant in northeastern North Carolina in order to make profitable a proposed pipeline extension into the area. *Id.* at 478.

161. This policy was dictated by certain tax considerations and because Transco's tariffs filed with the Federal Power Commission did not qualify it to sell directly to retail customers. *Id.* at 478.

162. Apparently the search and selection of an intermediary retailer was undertaken jointly by

turn sold to plaintiff.¹⁶³ Beginning in 1971 Transco cut back its supply of gas to NCNG, leading to curtailments in plaintiff's production. In the suit brought by CFI, the court denied defendant Transco's motion for summary judgment on plaintiff's claims for breach of contract as third-party beneficiaries of the Transco-NCNG agreement.

The district court found that while the North Carolina Supreme Court had adopted the analytical framework of the *Restatement (First) of Contracts*,¹⁶⁴ which recognizes third-party rights of action for donee and creditor beneficiaries and excludes incidental beneficiaries,¹⁶⁵ the general principle underlying North Carolina decisions was that the intention of the contracting parties, as manifested by all the surrounding circumstances, determined a third party's right to sue on the contract.¹⁶⁶ The court concluded that the North Carolina cases had not treated "the words 'donee' and 'creditor' and 'incidental' . . . as words of art but as ways to describe the result."¹⁶⁷

Assuming the existence of the requisite intent to benefit plaintiff, the court perceived an obstacle to a literal application of the *Restatement (First)* framework—the requirement that the promisor render the promised performance directly to the beneficiary and not merely enable the promisee to satisfy his obligation to the beneficiary.¹⁶⁸ Rather

FCA and Transco. Although NCNG was ultimately selected to serve the entire area, it had previously been agreed that FCA would organize a shell company to serve only the FCA plant. *Id.*

163. A factor that bore heavily on the court's consideration of the summary judgment motion was the highly dependent or conditional nature of each contract to the other. In an October 3, 1967, letter to NCNG, Transco agreed to the sale of certain additional gas volumes to be supplied to the new service area, conditioned upon NCNG's obtaining a firm commitment from the FCA plant to buy gas, and upon Transco's obtaining a certificate of public convenience and necessity. On November 10, 1967, FCA and NCNG entered into an agreement providing for a daily maximum supply to FCA of 50,000 Mcf of gas, conditioned upon the finalization of the Transco-NCNG service contract. The FCA plant was by far the largest user of gas in the new service area, receiving approximately one-third of the agreed additional gas volume. An NCNG officer later characterized the FCA-NCNG contract as a "transportation agreement drafted in the form of a purchase and sale." *Id.*

164. *See, e.g.,* *Matterns v. City of Winston-Salem*, 286 N.C. 1, 12, 209 S.E.2d 481, 487 (1974); *Vogel v. Reed Supply Co.*, 277 N.C. 119, 127, 177 S.E.2d 273, 278 (1970). *See also* *Chicago Title Ins. Co. v. Holt*, 36 N.C. App. 254, 244 S.E.2d 177 (1978); *Philco Fin. Corp. v. Mitchell*, 26 N.C. App. 264, 215 S.E.2d 823 (1975).

165. *RESTATEMENT (FIRST) OF CONTRACTS* § 133 (1932).

166. 448 F. Supp. at 479-80; *see, e.g.,* *Vogel v. Reed Supply Co.*, 277 N.C. 119, 177 S.E.2d 273 (1970); *Potter v. Carolina Water Co.*, 253 N.C. 112, 116 S.E.2d 374 (1960). The court's discussion of the issue of whether evidence other than the contract itself can be considered to determine the parties' intention is instructive. The court concluded that the rule that when a contract's terms are clear and unambiguous extrinsic evidence may not be adduced to explain or amplify the contract provisions is inapplicable to cases involving claims to third-party beneficiary status. 448 F. Supp. at 479-80.

167. 448 F. Supp. at 479.

168. *RESTATEMENT (FIRST) OF CONTRACTS* § 133(1)(b), illustration 9 (1932). *But see id.*,

than "undermine the overriding emphasis in the North Carolina cases . . . placed on the intention of the parties,"¹⁶⁹ the district court endorsed the *Restatement (Second) of Contracts* reformulation of third-party beneficiary theory. Accordingly, a party may qualify as a third-party beneficiary "if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and . . . the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance."¹⁷⁰ "Although the North Carolina courts have not expressly accepted this revision of the *Restatement (First)*," the court noted that "its treatment of third party beneficiaries is fully consistent with the decided cases."¹⁷¹ Applying this standard, the court held that the allegations created a material factual issue of whether plaintiff was intended to receive the benefit of the promised performance.

On its face, the court's approval of a strict "intention to benefit" test irrespective of the beneficiary's status as a "donee" or "creditor," and irrespective of the identity of the recipient of the promised performance represents a significant broadening of the protected category. Given the extensive dealings between plaintiff and Transco, the evidence of representations and reliances thereon, and the special "paper distributor" character of NCNG, however, "refusal of [a] remedy would have been out of harmony with generally prevailing ideas of justice and convenience."¹⁷² Moreover, a standard that excludes from the protected class third parties who are intended by the promisee to be the ultimate beneficiaries of the promisor's performance even though that performance will be rendered directly to the promisee would be difficult to justify on contract principles. Thus, the district court's endorsement of a strict "intention to benefit" test was necessary and proper in order to allow enough flexibility to reach the only sound re-

Comment d ("A contract for the benefit of a third person usually provides that performance shall be rendered directly to the beneficiary, but this is not necessarily the case."). Obviously, the Transco-NCNG-FCA relationship does not comport with the traditional third-party beneficiary alignment, see *Lawrence v. Fox*, 20 N.Y. 268 (1859). Defendant Transco was sued for breach of its promise to sell a given quantity of gas to NCNG, the promisee, and not for breach of a promise made to NCNG to deliver gas directly to plaintiff FCA. See also 4 A. CORBIN, CONTRACTS § 779D (1951); 2 WILLISTON ON CONTRACTS § 402 (3d ed. 1959).

169. 448 F. Supp. at 481.

170. RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tent. Drafts Nos. 1-7, 1973). *Id.*, Comment a expressly states that "neither promisee nor beneficiary is necessarily the person to whom performance is to be rendered, the person who will receive economic benefit, or the person who furnished the consideration."

171. 448 F. Supp. at 481.

172. 4A A. CORBIN, CONTRACTS § 772, at 2 (1951).

sult on the facts.¹⁷³

However justified on the particular facts, the result in *CF Industries*, by discarding the *Restatement (First)*'s basic framework and substituting a broad "intention to benefit" test, creates an intolerable danger that a court will subject a promisor to liability without justification. As a rule of law, the test offers a court little guidance in any particular fact situation and requires a court to undertake the difficult task of ascertaining on whom the contracting parties intended to confer benefits. These objections are not persuasive, however, because the North Carolina courts, while expressly purporting to follow the *Restatement (First)* approach, have consistently looked to the parties' intention as the controlling and decisive factor.¹⁷⁴ Thus, the change effected in *CF Industries* was more of form than substance—making the ostensible rule of decision comport with the actual one. Moreover, if the facts of *CF Industries* are used as the standard for requisite intent, the likelihood of a court unjustifiably extending liability is minimal and does not outweigh the potential for fairness and convenience in a particular case.¹⁷⁵

The authority of *CF Industries* was bolstered by the North Carolina Court of Appeals in *Johnson v. Wall*.¹⁷⁶ Plaintiffs in *Johnson* contracted to purchase a house on the condition that the vendor submit a negative termite report.¹⁷⁷ Terminix Service II, Incorporated, inspected the house and delivered a written report to the vendor that stated that

173. A general statement of the test and one that is consistent with the approach taken in *CF Industries* is found in MURRAY ON CONTRACTS § 279, at 571 (2d rev. ed. 1974): "When it appears from all of the circumstances surrounding the transaction that the *main purpose of the promisee* was to exact the promisor's performance for the *benefit* of the third party, such third party has a right to enforce the promisor's correlative duty."

174. See, e.g., *Matternes v. City of Winston-Salem*, 286 N.C. 1, 209 S.E.2d 481 (1974); *Vogel v. Reed Supply Co.*, 277 N.C. 119, 117 S.E.2d 273 (1970).

175. An issue not discussed by the court but clearly raised by the factual allegations was whether plaintiff could maintain an action based on the doctrine of promissory estoppel or under RESTATEMENT (SECOND) OF CONTRACTS § 90 (Tent. Drafts Nos. 1-7, 1973) which provides: "(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." The existence of not only a promise made directly to plaintiff that Transco should have reasonably expected to induce action, but also a binding promise made to NCNG for the benefit of plaintiff suggests that such a claim would have been actionable. The considerations a court must make to determine liability under a theory of third-party beneficiary are strikingly similar to those required under a theory of reliance upon a promise made to one party for the benefit of a third party (*Id.*, Comment c). Moreover, the latter theory requires only that the beneficiary foreseeably rely on the promise, rather than the more rigorous showing of an intention to benefit required by the former.

176. 38 N.C. App. 406, 248 S.E.2d 571 (1978).

177. *Id.* at 407, 248 S.E.2d at 572.

there was no evidence of termite infestation, past or present, and no structural weakness.¹⁷⁸ Vendor gave the report to plaintiffs, who relied on it in purchasing the house. Plaintiffs later discovered extensive structural damage caused by a previous termite infestation, and sued Terminix for the cost of repairing the house. At the close of all the evidence, the trial court allowed Terminix' motion for a directed verdict, two of the reasons being that plaintiffs had not produced evidence of privity of contract between plaintiff and Terminix or evidence of any legal duty Terminix owed plaintiff.¹⁷⁹

The court of appeals overruled the trial court and held that because vendor's unquestioned intent in engaging Terminix was to benefit plaintiff purchasers, and because Terminix knew or had reason to know the wood infestation report would be relied upon by a potential purchaser, plaintiffs could recover for breach of the vendor-Terminix contract.¹⁸⁰ Without saying so, the *Johnson* court followed the *CF Industries*¹⁸¹ rule of determining plaintiff's right of action by ascertaining the intention of the contracting parties to benefit the plaintiff as evidenced by all the circumstances under which the contract was made, with special regard to the main purpose of the entire transaction.¹⁸² The court did not cite the *Restatement (First)*, realizing perhaps that to

178. The findings showed that an employee of Terminix inspected the house and reported by radio to a secretary of Terminix that the termite damage was the same as that found in an earlier inspection, and that there was no present infestation. The written report introduced into evidence, however, stated there was no sign of either a present or past infestation. The report did indicate the existence of damage to structural items, but explained those items had been replaced and that there were presently no structural weaknesses. *Id.* at 408-09, 248 S.E.2d at 572-73.

179. *Id.* at 409, 248 S.E.2d at 573.

180. The court relied mainly on two factors in holding that Terminix could be held liable to the third-party buyer of the house. It emphasized that the seller-buyer contract expressly made the sale conditional on the seller's provision of a negative wood infestation report. Thus, it was clear that the principal purpose of the vendor, or promisee, in hiring Terminix was to obtain an inspection and report for the benefit of the buyer, the seller receiving only a nominal benefit. Second, the court noted that the Terminix-seller contract itself implied that Terminix was aware that the report was for the benefit of a third party. *Id.* at 410-11, 248 S.E.2d at 575.

181. See notes 157-175 and accompanying text *supra*.

182. It is uncertain from the opinion whether on remand plaintiff may sustain his burden of proof by merely showing that he received a false or inaccurate infestation report, or whether plaintiff must prove that defendant was negligent. The standard of liability issue is further obscured by the *Johnson* court's cryptic holding that plaintiff's evidence was sufficient to raise an issue of negligence on the part of defendant Terminix. 38 N.C. App. at 412-13, 248 S.E.2d at 575. Possible interpretations of the holding and its relation to plaintiff's contract action as a third-party beneficiary include (1) that the court was merely stating the well-settled rule that a qualified third-party beneficiary may sue *ex delicto* as well as *ex contractu*, *Toone v. Adams*, 262 N.C. 403, 407, 137 S.E.2d 132, 135 (1964); (2) that although the suit was in contract, the exterminator's contractual duty to the promisee or third party was one of ordinary care and diligence. See note 187 *infra*. Absent any express warranty as to the accuracy of the report, and assuming that no implied warranty attached because the inspection and report is a service, see *Jones v. Clark*, 36 N.C. App. 327, 330, 244 S.E.2d 183, 185 (1978), it is unlikely that the court intended that plaintiff recover

deny plaintiff's cause of action because he was not a donee, creditor or direct recipient of the promised performance was unjustifiable in light of the clear evidence that the vendor had exacted Terminix' performance for the benefit of the plaintiff. The *Johnson* decision not only lends support to *CF Industries* and its eschewal of a categorical approach, but also illustrates the need for North Carolina expressly to discard the *Restatement (First)* and adopt the *Restatement (Second)* test.¹⁸³

In *Chicago Title Insurance Company v. Holt*,¹⁸⁴ the North Carolina Court of Appeals upheld the dismissal of a third-party breach of contract action against an attorney who had certified title to real property and undertaken to close a five-party transaction¹⁸⁵ on the property. As a condition to insuring the mortgagee against any loss arising from a defect in the title to a group of newly constructed condominiums, plaintiff insurer required an indemnification agreement from the builder of the project. Relying on the attorney's certification of title to plaintiff, the general contractor signed the agreement and thereby warranted there were no unpaid materialmen or subcontractors, and agreed to indemnify plaintiff should it incur liability because of mechanics' liens having priority over the deeds of trust held by the mortgagee. Subsequently, plaintiff satisfied a judgment lien held by one of the builder's suppliers and instituted an action against the builder for indemnification. Defendant builder cross-claimed against the seller's attorney, who had handled the closing, for failure to exercise reasonable care in determining the existence of unpaid lien creditors.¹⁸⁶

Addressing this issue of first impression, the court of appeals at the

without a showing of negligence. The court did not discuss whether plaintiff could maintain a tort action independently of its third-party beneficiary status.

183. In holding that an exterminating company is liable to a person who purchases property in reliance upon a false or inaccurate wood infestation report provided to the vendor, North Carolina joins only a few jurisdictions that have so held. See *Hardy v. Carmichael*, 207 Cal. App. 2d 218, 24 Cal. Rptr. 475 (1962); *Wice v. Shilling*, 124 Cal. App. 2d 735, 269 P.2d 231 (1954); *Hamilton v. Walker Chem. & Exterminating Co.*, 233 So. 2d 440 (Fla. Ct. App. 1970); *Ruekenkorf v. McCartney*, 121 So. 2d 757 (La. Ct. App. 1960).

184. 36 N.C. App. 284, 244 S.E.2d 177 (1978).

185. Interested parties included the buyer, seller, lender, mortgagee's insurer, and the general contractor. *Id.* at 285-86, 244 S.E.2d at 178-79.

186. *Holt*, the general contractor, set forth two other grounds for relief in his complaint: (1) that defendant attorney was liable to *Holt* for any loss because of his undertaking to represent multiple parties at the closing; and (2) that the attorney was negligent in advising *Holt* to sign the indemnification agreement without first exercising his affirmative duty to discover the existence of any materialmen's or mechanics' liens. *Id.* at 286, 244 S.E.2d at 179. The court held the claims insufficient to state a claim upon which relief could be granted on the ground of lack of privity between *Holt* and the attorney. *Id.* at 288, 244 S.E.2d at 180.

outset decided that an action for attorney malpractice sounds in contract rather than tort, and thus may properly be brought only by those in privity of contract with the attorneys.¹⁸⁷ Because the attorney's client was the seller,¹⁸⁸ defendant builder's claim was barred unless he qualified as a third-party beneficiary of the attorney-seller employment contract.

The court purported to follow the third-party beneficiary categorization of the *Restatement (First)*¹⁸⁹ and summarily dismissed the claim because the builder was neither a donee nor creditor beneficiary. The court proceeded, however, to consider whether the vendor and attorney intended to benefit the builder and concluded that because the builder did not allege that the attorney promised to, or did in fact, certify the title to the builder, the builder had failed to state a claim upon which relief could be granted.¹⁹⁰

Although not entirely clear, the *Chicago Title* holding suggests that as a matter of law a party to a real estate closing, who is not in privity

187. The court supported its decision with the following statement of the general rule as set forth in 7 C.J.S. *Attorney and Client* § 140, at 978:

Although the liability of an attorney on the ground of negligence is ordinarily enforced by an action on the case for negligence in the discharge of his professional duties, the liability in reality rests on the attorney's employment by the client and is *contractual in its nature*. Hence, before the attorney can be made liable, it must appear the loss for which he is sought to be held arose from his failure or neglect to discharge some duty which was fairly within the purview of his employment. Moreover, *an attorney is liable for negligence in the conduct of his professional duties to his client alone*, that is, to the one between whom and the attorney the *contract* of employment and service existed, and not to third parties.

Quoted in 36 N.C. App. at 287, 244 S.E.2d at 180 (emphasis added by court).

The preceding excerpt is instructive because it explains the relationship between negligence and breach of contract in the case of an action for malpractice. Thus, there is nothing inconsistent about defining a breach of contract in terms of an allegation of negligence because the contractual standard is essentially an implied representation to the client that the attorney "will exercise reasonable and ordinary care and diligence in the use of his skill and in the application of his knowledge to his client's cause." *Hodges v. Carter*, 239 N.C. 517, 519, 80 S.E.2d 144, 146 (1954).

188. The court's conclusion that the attorney represented the seller at the closing is contrary to common practice and the normal expectations of the parties. The court did not articulate what factors determined the attorney-client relationship, and, therefore, the *Chicago Title* dictum creates uncertainty concerning whether the payment of attorneys' fees and being in the position of the party who naturally desires the assurances that title to the property is free and clear of encumbrances is enough to establish privity with the closing attorney.

189. *RESTATEMENT (FIRST) OF CONTRACTS* § 133 (1932).

190. Apparently the materialman's lien constituting the title defect was unrecorded at the time of the recording of the deed of trust. N.C. GEN. STAT. § 44A-12(b) (1969) permits such liens to be filed within four months of the work's completion. The lien is deemed to take effect from the time of the first furnishing of materials to the property, *id.*, which explains the insurer's liability for the lien. Defects not discoverable by an examination of the public records are generally either expressly or impliedly excluded from such certifications. Therefore, absent an allegation that the attorney purported to certify that no unrecorded liens existed, it is unlikely that the builder would have prevailed had the claim been actionable.

of contract with the certifying attorney, may sue the attorney only if the party is a recipient of the certification.¹⁹¹ On third-party beneficiary principles the rule is problematic in that it conclusively presumes that only the parties to whom a certification was addressed were intended to benefit from it, and thus potentially distorts the realities of a particular real estate closing. Moreover, there seems to be no valid justification, in policy or otherwise, for precluding liability in the case of an attorney who furnishes a title certification to one party for the benefit of a third party, when an exterminating company that provides an infestation report under the same circumstances may be liable as in *Johnson v. Wall*.¹⁹² In addition, the rule may constitute a treacherous pitfall to the real estate buyer who unsuspectingly relies on a title certification issued to his lender, and subsequently brings a malpractice action against the certifying attorney for failure to discover a title defect. The problem is compounded by the common practice of one attorney closings, and the consequent failure to define the attorney-client relationship.¹⁹³

C. Unfair Trade

In *Bache Halsey Stuart, Inc. v. Hunsucker*,¹⁹⁴ the North Carolina Court of Appeals held that the federal Commodity Exchange Act¹⁹⁵ as amended by the Commodity Futures Trading Commission Act¹⁹⁶ preempted the application of the state unfair trade practices law, G.S. 75-1.1,¹⁹⁷ to transactions involving the purchase or sale of commodity futures contracts. Plaintiff, a stock and commodities broker, sued to recover a deficit balance in defendant's commodities account. Defendant counterclaimed that Bache had committed unfair and deceptive acts in

191. Although there is language in the opinion that indicates the court was applying a strict "intention to benefit" test to the complaint to ascertain whether the seller (promisee) intended that the contractor benefit or rely on the title certification, the court's affirmation of the dismissal of the claim in the face of allegations that the attorney advised the contractor to sign the lien waiver suggests that intention was not determinative. The disposition of the case indicates that only parties to whom a certification was delivered, or promised to be delivered, may qualify as a third-party beneficiary.

192. See notes 176-183 and accompanying text *supra*.

193. See generally Whitman, *Transferring North Carolina Real Estate Part I: How the Present System Functions*, 49 N.C.L. REV. 413 (1971).

194. 38 N.C. App. 414, 248 S.E.2d 567 (1978), *cert. denied*, 296 N.C. 583, — S.E.2d — (1979).

195. 7 U.S.C. §§ 1-22 (1976).

196. Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified in scattered sections of 5, 7 U.S.C.).

197. The statute at issue was the former § 75-1.1(a) that provided as follows: "Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful." Law of June 12, 1969, ch. 833, 1969 N.C. Sess. Laws 930 (formerly codified at N.C. GEN. STAT. § 75-1.1(a) (1975)) (amended 1977).

violation of G.S. 75-1.1 by making unauthorized sales and purchases of commodities in defendant's name, and subsequently liquidating defendant's accounts.¹⁹⁸

Because the Commodity Exchange Act granted exclusive jurisdiction¹⁹⁹ to the Commodity Futures Trading Commission to hear customer complaints and award monetary damages²⁰⁰ for the activities alleged,²⁰¹ the court inferred that Congress sought to regulate unfair and deceptive practices in the commodity trading field to the exclusion of the states. The court was not persuaded that a private action under G.S. 75-1.1 was merely an action at common law not in conflict with the federal regulatory scheme.²⁰² The court reasoned that because a finding that plaintiff had violated G.S. 75-1.1 could expose it to a host of legislatively created sanctions in addition to those sought, the private action was tantamount to state regulation, and thus preempted.²⁰³

The *Bache* holding that state regulation of commodities trading is preempted is in line with the few decisions that have addressed the question.²⁰⁴ Language in the Commodity Exchange Act that "the

198. 38 N.C. App. at 417, 248 S.E.2d at 568.

199. The jurisdiction of the Commission is set out in 7 U.S.C. § 2 (1976) and provides in part as follows:

Provided, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 15a of this title: *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State

200. *Id.* § 18.

201. Federal courts have held it a violation of the Commodity Exchange Act for an account executive in the commodity brokerage business to intentionally carry on trading transactions not authorized by his customers. *Haltmier v. Commodity Futures Trading Comm'n*, 554 F.2d 556 (2d Cir. 1977); *Silverman v. Commodity Futures Trading Comm'n*, 549 F.2d 28 (7th Cir. 1977).

202. Several courts have held that a purpose of the language in 7 U.S.C. § 2 (1976) that "[n]othing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State" is to preserve a court's jurisdiction over claims arising out of a violation of the common law. *See Arkoosh v. Dean Witter & Co.*, 415 F. Supp. 535 (D. Neb. 1976); *E.F. Hutton Co. v. Lewis*, 410 F. Supp. 416 (E.D. Mich. 1976).

203. Under N.C. GEN. STAT. § 75-14 (1975) the attorney general may obtain injunctive relief against violations of § 75-1.1. In addition, he is entitled to seek a court order to restore money or property or cancel any contracts obtained through violation of the statute. *Id.* § 75-15.1.

204. *See International Trading, Ltd. v. Bell*, 556 S.W.2d 420 (Ark. 1977), *cert. denied*, 435 U.S. 941 (1978); *State v. Money Int'l, Ltd.*, 527 S.W.2d 804 (Tex. Civ. App. 1975). *See also SEC v. Uninvest, Inc.*, 405 F. Supp. 1057 (D.C. Ill. 1975), *remanded*, 556 F.2d 584 (7th Cir. 1977) (SEC preempted from suing dealer in commodity options). The *Bache* court found the *Bell* case partic-

Commission shall have exclusive jurisdiction with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery"²⁰⁵ evinces a clear intent on the part of Congress to vest in the Commission exclusive jurisdiction over the regulation of transactions involving commodity futures contracts, and to supersede state regulation of the same subject matter.²⁰⁶ Assuming that G.S. 75-1.1 and its concomitant enforcement provisions²⁰⁷ are regulatory in nature, some uncertainty still remains about whether a private action pursuant to a regulatory statute is likewise preempted.²⁰⁸ The court's conclusion that a G.S. 75-1.1 private action could potentially frustrate the federal scheme was sound given the structure of the statute and Congress' objective of providing a centralized regulatory authority designed to establish relatively consistent and uniform standards of conduct in commodity markets. Moreover, the Act's provision of a complete administrative procedure for the hearing of customer complaints and the awarding of monetary damages implies that Congress intended that the Commission's exclusive jurisdiction extend to private actions pursuant to substantive regulatory law.²⁰⁹

ularly persuasive. In that case, the Arkansas securities commissioner sought an injunction against a commodities investment firm under ARK. STAT. ANN. § 67-1236(a) (Repl. 1966), a state statute designed to prevent fraud or deceit in the trading of securities. The Arkansas Supreme Court held that the trial court had no jurisdiction under the state securities law to regulate conduct in the area of commodity futures in light of a pervasive federal regulatory scheme and congressional intent to give the Commission exclusive jurisdiction.

205. 7 U.S.C. § 2 (1976).

206. The Senate Agriculture and Forestry Committee explained the meaning of the "exclusive jurisdiction" language of 7 U.S.C. § 2 (1976) as follows:

The *House* bill provides for exclusive jurisdiction of the Commission over all futures transactions. However, it is provided that such exclusive jurisdiction would not supersede or limit the jurisdiction of the Securities and Exchange Commission or other regulatory authorities.

The [Senate] *Committee* amendment retains the provision of the *House* bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, and commodity options; (b) the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies

S. REP. NO. 1131, 93d Cong., 2d Sess. 54 (1974), reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5848. The Senate provision was accepted by the Conference Committee. H.R. CONF. REP. NO. 93-1383, 93d Cong., 2d Sess. 4 (1974), reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5894, 5897.

207. N.C. GEN. STAT. §§ 75-1 to -29 (1975 & Cum. Supp. 1977).

208. See Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1, 32-36 (1976).

209. The court stressed that the customer could nevertheless maintain a traditional common law action in state court. The court construed the second proviso of the jurisdictional grant, quoted in note 199 *supra*, as authorizing state and federal courts to adjudicate claims arising out of a violation of the common law. 38 N.C. App. at 420-21, 248 S.E.2d at 570.

In another case involving former G.S. 75-1.1, the court of appeals decided whether certain instances of false advertising violated that statute's prohibition of "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." Plaintiff in *Harrington Manufacturing Co. v. Powell Manufacturing Co.*²¹⁰ alleged that Powell, a competitor, had violated G.S. 75-1.1 by advertising that "*only* the Powell Combine primes lugs through tips" when, in fact, plaintiff's combine also primed lugs through tips.²¹¹ Defendant Powell counterclaimed that plaintiff had similarly violated the statute by falsely advertising that plaintiff's tobacco primer was "years ahead of any other tobacco harvester on the market,"²¹² and that plaintiff's loading rack and curing barns were "stronger than Powell's" and had a greater loading capacity.²¹³ The court of appeals upheld dismissal of both claims on the ground that the representations, even if proved false, "did not . . . go so far beyond the tolerable limits of puffing as to constitute unfair acts proscribed by G.S. 75-1.1."²¹⁴ Whether false representations exceed the bounds of fairness in any particular case depends upon the extent to which the typical buyer would rely on such advertising in making a purchase. The court reasoned that when the advertisement concerned an expensive product and was aimed at a group of knowledgeable buyers, prospective purchasers would not normally rely solely upon a magazine advertisement or media broadcast, especially when accurate technical information was available.²¹⁵

Although the court's ruling that puffing is not deceptive or unfair within the meaning of G.S. 75-1.1 was sound,²¹⁶ such a conclusion on the particular facts of this case may be criticized on several fronts. First, it is a close question whether representations of specific fact that imply that the representer has personal knowledge of the truth of the assertions (e.g., "greater loading capacity," "the *only* harvester that primes lugs through tips") constitute mere puffing, no matter how so-

210. 38 N.C. App. 393, 248 S.E.2d 739 (1978), *cert. denied*, 296 N.C. 411, 251 S.E.2d 469 (1979).

211. *Id.* at 397, 249 S.E.2d at 742.

212. *Id.* at 402, 248 S.E.2d at 744.

213. *Id.* at 402, 248 S.E.2d at 745.

214. *Id.* at 403, 248 S.E.2d at 745.

215. *Id.* at 400-01, 248 S.E.2d at 744.

216. See E. KINTNER, A PRIMER ON THE LAW OF DECEPTIVE PRACTICES 319-325 (1971). N.C. GEN. STAT. § 75-1.1(a) (Cum. Supp. 1977) is a copy of the language of § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1)-(9) (1976); the Federal Trade Commission and the reviewing courts have recognized that puffing and sales talk are not unlawful, and those decisions are generally consistent with state law definitions of puffing. See *Carlay Co. v. FTC*, 153 F.2d 493 (7th Cir. 1946); *Kidder Oil Co. v. FTC*, 117 F.2d 892 (7th Cir. 1941).

phisticated purchasers may be.²¹⁷ It seems that a prospective purchaser could justifiably rely on such an advertising claim.

Second, although the court's rationale is not entirely clear, it seemed to reason alternatively that because buyers of tobacco farming machinery do not rely on advertising claims in making their purchases, no deception had occurred.²¹⁸ Such a conclusion represents a questionable excursion into fact-finding and arguably the issue of customer reliance should have been remanded for a determination by the trier of fact.²¹⁹ Moreover, the wisdom of this rationale from a policy standpoint is questionable in that it sanctions virtually any advertising representation made in this market no matter how untrue or deceptive it appears to be. To this extent, the result undermines G.S. 75-1.1's purpose of promotion of commercial honesty and competition on the merits.²²⁰

The court further held that averments in the counterclaim that plaintiff had "passed off" a piece of Powell's tobacco harvesting machinery as plaintiff's own product alleged an unfair or deceptive act under former G.S. 75-1.1.²²¹ Plaintiff incorporated Powell's "CutterBar" (a defoliator) into one of its automatic tobacco harvesters and demonstrated the harvester to prospective purchasers without identifying the blade assembly as having been manufactured by Powell.²²² Al-

217. Whether a representation is puffing or sales talk depends on the nature of its language. Traditionally, puffing has consisted of glittering general statements rather than specific representations of fact. See E. KINTNER and cases cited note 216 *supra*.

218. See 38 N.C. App. at 401, 248 S.E.2d at 744.

219. For a statement of proper role of judge in an action under N.C. GEN. STAT. § 75-1.1, see *Hardy v. Toler*, 288 N.C. 303, 218 S.E.2d 342 (1975).

220. Law of June 12, 1969, ch. 833, 1969 N.C. Sess. Laws 930 (formerly codified at N.C. GEN. STAT. §§ 75-1.1(b) (1975)) (repealed 1977), provides:

The purpose of this section is to declare, and to provide civil legal means to maintain, ethical standards of dealings between persons engaged in business, and between persons engaged in business and the consuming public within this State, to the end that good faith and fair dealings between buyers and sellers at all levels of commerce be had in this State.

221. The court recognized that this form of passing off differed from the traditional common law action for the passing off of one's goods as those of a competitor. 38 N.C. App. at 404, 248 S.E.2d at 746. See generally Aycock, *Antitrust and Unfair Trade Practice Law in North Carolina—Federal Law Compared*, 50 N.C.L. REV. 199 (1972).

222. In August 1974 Harrington purchased a Powell "CutterBar" and incorporated it into one of its automatic tobacco harvesters. The patented "CutterBar" (Powell's trade name for the mechanical harvesting device generically known as the "splinter knife" type defoliator) was unique in that it consisted of a blade assembly with upward revolving blades. Harrington added a hydrosynchronizer, a device that had been invented by Harrington's engineers that synchronized by hydraulics the timing of the knife of the blade assembly with the forward motion of the harvester. Harrington demonstrated this innovation to about 300 farmers without identifying the blade assembly as Powell-made. 38 N.C. App. at 399, 248 S.E.2d at 743.

though plaintiff had a license to produce the CutterBar,²²³ the court held that by using Powell's actual product in its demonstrations plaintiff had misappropriated a variety of values flowing from the quality of the product, including the large investment that Powell had made in experimentation, engineering and development to bring its CutterBar to a high level of quality and efficiency.²²⁴

In upholding Powell's allegation that the use of its CutterBar in plaintiff's harvester demonstration without so notifying prospective purchasers constituted an unfair method of competition under G.S. 75-1.1, the court did not identify the exact nature of the interest being protected. The injury alleged was actually a mixture of two distinct wrongs: (1) the plaintiff obtained an unfair advantage over its competitors by doing demonstrative advertising without having to incur the investment and manufacturing costs required for producing its own CutterBar,²²⁵ and (2) plaintiff's failure to fully disclose the defoliator's make amounted to a representation that plaintiff had manufactured that particular defoliator with that degree of quality, causing prospective harvester buyers to purchase from plaintiff when they may not have otherwise.²²⁶ The former type of appropriation, that of Powell's "production" value, appears *de minimis* because plaintiff would eventually have to duplicate Powell's investment in order to fulfill its sales contracts. Thus, while the advertising short-cut taken by plaintiff may have enabled it to make some sales a few months before it could have otherwise, the absence of any long-term crippling effect on competitors minimizes its importance.

Whether the alleged wrong consisting of plaintiff's failure to identify the defoliator as that of a competitor is legally sufficient to support a private action for the recovery of monetary damages under G.S. 75-

223. In 1962, Powell obtained a nonexclusive license to manufacture and sell the CutterBar. On November 15, 1974, the patentee granted a nonexclusive license to Harrington to produce its own device. Harrington demonstrated its harvester with the incorporated CutterBar in September and October of 1974. Apparently, Harrington was using a Powell CutterBar in its demonstrations until it began producing its own.

224. 38 N.C. App. at 404, 248 S.E.2d at 746.

225. See generally *International News Serv. v. Associated Press*, 248 U.S. 215 (1918).

226. The difference between the two is made apparent by positing that plaintiff had fully disclosed to its customers that the defoliator demonstrated was a Powell CutterBar. Plaintiff's customers would not then have attributed any desirable characteristics of the product as deriving from plaintiff and Powell could hardly be heard to complain that plaintiff was diverting customers. But despite full disclosure of the defoliator's source a misappropriation would nevertheless exist consisting essentially of plaintiff's demonstrating its harvester with the CutterBar without having incurred the investment and manufacturing costs required to produce a CutterBar.

1.1²²⁷ is difficult to assess in light of the lack of case law and extra-statutory expressions of legislative intent. Powell's argument was that plaintiff, by using Powell's actual product in its advertising demonstrations, misappropriated to its own benefit certain values of "quality" and "efficiency" inhering in the CutterBar that deceived prospective purchasers into incorrectly attributing such desirable characteristics to plaintiff's initiative.

Although plaintiff's act strikes one as unfair in that the alleged wrongdoer is reaping where he has not sown, the essence of the misappropriation in this instance was plaintiff's misrepresentation to potential purchasers that the demonstrated harvester and blade assembly was of its own manufacture. While a misappropriation that tends to deceive customers into confusing the wrongdoer's goods with those of a competitor would clearly be actionable, an inherent difficulty of proof arises when what is alleged to have been misappropriated is other than an identifying mark or characteristic.²²⁸ Because a finding of liability subjects the wrongdoer to treble damages,²²⁹ and because the language in the private remedy statute is compensatory,²³⁰ on remand it should not be sufficient for Powell to show merely that plaintiff's sales of harvesters were proximately caused by its use of Powell's CutterBar; instead, Powell should be required to show, that customers were actually diverted.²³¹ Factors that militate against the existence of actual injury to Powell are that the CutterBar was a component of the entire product being demonstrated and that plaintiff possessed a license to make the

227. If any person shall be injured or the business of any person, firm or corporation shall be broken up, destroyed or injured by reason of any act or thing done by any other person, firm or corporation in violation of the provisions of this Chapter, such person, firm or corporation so injured shall have a right of action on account of such injury done, and if damages are assessed by a jury in such case judgment shall be rendered in favor of the plaintiff and against the defendant for treble the amount fixed by the verdict.

N.C. GEN. STAT. § 75-16 (Cum. Supp. 1977).

228. Judge Clark in *California Apparel Creators v. Wieder of Cal., Inc.*, 162 F.2d 893 (2d Cir. 1947), stated the general common law rule:

To recover damages or to receive protective relief against the actions of these defendants, plaintiffs must therefore show not only a representation by defendants which is false and deceitful in the sense of luring customers to their doors wrongfully, but also that plaintiffs have lost their own rightful custom thereby.

Id. at 900.

229. N.C. GEN. STAT. § 75-16 (Cum. Supp. 1977), *quoted in note 227 supra*.

230. *Id.*

231. Merely because the nondisclosure is couched in terms of a misappropriation, Powell should not be relieved of the burden of proving diversion. The theory underlying such a "misrepresentation" is essentially no different from that of the traditional common law tort of passing off. When a seller palms off his wares as those of a competitor, he diverts customers by appropriating to his own use a competitor-created value, namely, customer recognition of a mark or other identifying feature.

defoliator. Thus, given the evanescence of the values alleged to have been misappropriated and the conjectural nature of any injury, absent an allegation that plaintiff's customers were confused about the source and therefore would have purchased from Powell but for the misappropriation, the claim should arguably be dismissed.²³² To permit a jury to speculate on the nature and extent of Powell's injury would, it seems, be to punish plaintiff for the act of using Powell's CutterBar and thus grant a remedy not authorized by G.S. 75-16's compensatory provisions.

JEFFREY A. ALLRED
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IV. CONSTITUTIONAL LAW

A. *Full Faith and Credit*

In *Vincent v. Vincent*,¹ the North Carolina Court of Appeals upheld a district court ruling that an Alabama court's judgment modifying a North Carolina alimony decree² terminated plaintiff's rights under the North Carolina decree as of the date the Alabama judgment was entered.³ Recognizing a split in authority on whether defendant is relieved of his obligation when the foreign judgment is entered or only when he obtains a judgment in North Carolina that gives full faith and credit to the foreign decree, the court held that in order to give the Alabama decree the same effect it would have in Alabama, as is required by the full faith and credit clause,⁴ the entry of the foreign judg-

232. Had Powell alleged that plaintiff's use of its CutterBar amounted to a representation that plaintiff was not selling Powell CutterBars and thus purchasers of plaintiff expected to get a Powell-made blade assembly on their harvesters, the element of diversion would have been made out. Without a customer associating the misappropriated values with the complainant (or the nonexistence of other factors indicating that the purchasers would have bought from the complainant but for the misrepresentation, e.g., only two firms) such a claim seeking monetary damages is deficient.

1. 38 N.C. App. 580, 248 S.E.2d 410 (1978).

2. The Alabama court could modify the North Carolina decree to the same extent that a North Carolina court could, and the Alabama court's finding of changed circumstances (regarding health and financial resources of defendant husband) was sufficient under North Carolina law to allow it to modify the decree. *Id.* at 582-83, 248 S.E.2d at 412.

3. *Id.* at 581, 248 S.E.2d at 411.

4. U.S. CONST. art. IV, § 1.

ment must immediately terminate plaintiff's rights under the North Carolina decree.⁵

B. First Amendment

A federal district court, in *Radford v. Webb*,⁶ declared unconstitutional a North Carolina statute prohibiting the use of profane, indecent and threatening language over a telephone.⁷ A virtually identical Virginia statute had been declared unconstitutionally overbroad by the United States Court of Appeals for the Fourth Circuit because included in the prohibition was language that was not obscene but was protected by the first amendment.⁸ The court of appeals found that the statute could be more narrowly drawn to meet the legitimate state interest in proscribing the use over the telephone of obscene language without infringing constitutionally protected speech.⁹ The district court in *Radford* viewed the Virginia and North Carolina statutes as virtually indistinguishable,¹⁰ and found no North Carolina cases construing the language of the statute that restricted its meaning to an allowable prohibition against obscene phone calls.¹¹ Without such a limitation by judicial decision, the terms "profane, indecent and threatening" could include mere "heat of the moment" threats and words with an offensive connotation that are protected by the first amendment.¹² The statute was thus held to be overbroad and an unconstitutional infringement on

5. 38 N.C. App. at 583, 248 S.E.2d at 412.

The North Carolina Court of Appeals also considered the effect of the full faith and credit clause in *Sainz v. Sainz*, 36 N.C. App. 744, 245 S.E.2d 372 (1978). Plaintiff wife obtained a specific performance decree in a New York court under an extrajudicial separation agreement. The decree was enforceable by civil contempt proceedings in New York. *Id.* at 745, 245 S.E.2d at 373. The court held that although the specific performance decree was entitled to recognition in North Carolina, the full faith and credit clause did not bind the state to enforce the decree by civil contempt proceedings. Because such proceedings would constitute imprisonment for debt, which is prohibited by N.C. CONST. art. I, § 28, the decree would not be so enforced. *Id.* at 747-48, 245 S.E.2d at 374-75.

6. 446 F. Supp. 608 (W.D.N.C. 1978).

7. The statute provides that it is unlawful "[t]o use in telephonic communications any words or language of a profane, vulgar, lewd, lascivious or indecent character, nature or connotation" and "[t]o use in telephonic communications any words or language threatening to inflict bodily harm to any person." N.C. GEN. STAT. § 14-196(a)(1)(2) (1969).

8. The Virginia statute challenged for overbreadth in *Walker v. Dillard*, 523 F.2d 3 (4th Cir.), *cert. denied*, 423 U.S. 916 (1975), provided: "If any person shall curse or abuse anyone, or use vulgar, profane, threatening or indecent language over any telephone in this State, he shall be guilty of a misdemeanor . . ." VA. CODE § 18.1-238 (1975) (repealed 1975).

9. *Walker v. Dillard*, 523 F.2d 3, 5-6 (4th Cir.), *cert. denied*, 423 U.S. 906 (1975).

10. 446 F. Supp. at 610.

11. *Id.* at 611.

12. *Id.* at 610-11.

first amendment freedom of speech.¹³ In so holding the district court refused to follow a North Carolina Court of Appeals case, *In re Simmons*,¹⁴ which had held that G.S. 14-196(a)(1)¹⁵ was not unconstitutionally overbroad.¹⁶ The district court's decision not to follow *Simmons* is understandable in light of the inadequate analysis of the statute in *Simmons*.

The court of appeals in *Simmons* failed to analyze the statute according to the accepted test for overbreadth of a statute regulating speech: whether the statute is drawn to prohibit only speech not protected by the first amendment (for example, obscenity).¹⁷ The court reasoned that because the state could prevent intrusion by telephone on individuals' privacy in some situations,¹⁸ it could prohibit the use of language that was clearly "lewd, lascivious and indecent."¹⁹ Although the court was correct that the state can regulate some speech, the conclusion that lewd speech can be prohibited fails to consider whether speech that is lewd and indecent, though morally and socially objectionable, is also protected by the first amendment and therefore not properly subject to regulation. The district court's finding in *Radford* that the statute prohibited such language protected by the first amendment supplied the overbreadth analysis that the North Carolina Court of Appeals had omitted in upholding the statute in *Simmons*.²⁰

C. Fourteenth Amendment: Equal Protection

In *Spencer v. Spencer*,²¹ defendant husband claimed that the North Carolina privy examination statute²² violated the equal protec-

13. *Id.* at 611.

14. 24 N.C. App. 28, 210 S.E.2d 84 (1974).

15. N.C. GEN. STAT. § 14-196(a)(1) (1969).

16. 446 F. Supp. at 611.

17. See, e.g., *Gooding v. Wilson*, 405 U.S. 518 (1972) (statute proscribing the use of abusive language in presence of others held unconstitutionally vague).

18. Statutes may, for example, proscribe the use of obscene language, which is not protected by the first amendment. *Id.*

19. 24 N.C. App. at 30-31, 210 S.E.2d at 86.

20. In another first amendment case, a federal district court, in *Hart Book Stores, Inc. v. Edmisten*, 450 F. Supp. 904 (E.D.N.C. 1978), declared N.C. GEN. STAT. § 14-202.11 (Cum. Supp. 1977) unconstitutional. The court held that the statute, which limited the number of adult establishments in a building to one, violated equal protection and infringed plaintiff's first amendment freedom of speech without advancing the state's interest in preventing community decay. 450 F. Supp. at 908. For a thorough discussion of this case, see *Survey of Developments in North Carolina Law, 1977*, 56 N.C.L. REV. 843, 944-46 (1978).

21. 37 N.C. App. 481, 246 S.E.2d 805, cert. denied, 296 N.C. 106, 249 S.E.2d 804 (1978).

22. Law of Feb. 12, 1872, ch. 193, § 27, 1871-72 N.C. Pub. Laws 336 (formerly codified as amended at N.C. GEN. STAT. § 52-6 (1976)(repealed 1977)).

tion clauses of the United States and North Carolina constitutions.²³ The statute provided that contracts between husband and wife that effected a change in the wife's real estate or income from that real estate were invalid unless the wife was examined by a judicial officer to determine that the contract was not unreasonable or injurious to the wife. The trial court rejected defendant's constitutional challenges,²⁴ and the court of appeals affirmed.

In defense to an action by plaintiff wife under the terms of a separation agreement, defendant asserted that the statute was unconstitutional because it did not afford men as well as women the protection of the exam.²⁵ The court of appeals concluded that defendant did not have standing to challenge the constitutionality of the statute because the appropriate remedy upon a finding of unconstitutionality would be elimination of the privy exam altogether and would not affect defendant.²⁶ The court premised this conclusion on the fact that the privy exam requirement is an impermissible restriction on the right to contract rather than a valuable right of itself.²⁷ Thus its application should be abrogated entirely rather than extended. Despite denial of standing to defendant, the court undertook an historical and constitutional analysis of the statute and concluded that were the issue properly before it the court's finding would be that the statute was unconstitutional.²⁸

D. Fourteenth Amendment: Due Process

1. Pursuit of Lawful Occupation

In *Duggins v. North Carolina Board of Certified Public Accountant*

23. 37 N.C. App. at 484, 246 S.E.2d at 807; see U.S. CONST. art. XIV; N.C. CONST. art. I, § 19.

24. 37 N.C. App. at 483, 246 S.E.2d at 807.

25. *Id.* at 486-88, 246 S.E.2d at 809-10.

26. *Id.* at 488-89, 246 S.E.2d at 810. The court also noted that defendant, due to his high level of education and experience would not have benefited from an exam if it were available to him, and therefore defendant had suffered no injury. *Id.* at 489, 246 S.E.2d at 811.

27. *Id.* at 488, 246 S.E.2d at 810.

28. *Id.* at 488-89, 246 S.E.2d at 810. In another equal protection case, the North Carolina Supreme Court, in *State ex rel. Utilities Comm'n v. Edmisten*, 294 N.C. 598, 242 S.E.2d 862 (1978), held that a Utilities Commission order allowing natural gas companies to obtain direct rate increases to cover the costs of gas exploration without bringing general rate cases did not violate equal protection. *Id.* at 611-12, 242 S.E.2d at 810-11. The court said that because the entire public would benefit from increased gas supplies, the rates did not have to be applied only to customers who would benefit directly from the exploration or who were responsible for the shortages. *Id.* For a discussion of the due process claims raised by plaintiff, see notes 55-62 and accompanying text *infra*. For a discussion of the administrative issues raised in this case, see this Survey, *Administrative Law: Regulation of Utilities*.

Examiners,²⁹ the North Carolina Supreme Court upheld against a due process challenge the North Carolina statutory requirement that an applicant for a CPA license must have had two years of experience with a CPA in the "public practice."³⁰ The statute defines a person engaged in the public practice of accounting as one who holds himself out to the public as an accountant offering to perform any or all of the services ordinarily performed by those who are accountants.³¹ Plaintiff Duggins had passed the CPA exam and had worked with a CPA in a law firm, mostly on tax accounting matters, for four years.³² The Board of Examiners refused to issue a license to Duggins.³³ Because a lawyer dealing with tax matters does not hold himself out to the public as an accountant, performing solely accountant's services, Duggins did not have the requisite experience with an accountant in the "public practice."³⁴

Duggins challenged the requirement that the experience be with a CPA in public practice as bearing no rational relationship to the state's objective of ensuring that only capable, qualified, experienced people be certified.³⁵ He argued that experience with an accountant in a law firm dealing with accounting matters provided the same or equivalent experience and met the state objectives.³⁶ The supreme court rejected plaintiff's contention, holding instead, as did the Board of Examiners, that work with a CPA in the public practice may expose an accountant to a wider range of experience than work with an accountant in a law firm on more narrowly defined tax matters.³⁷ Therefore the statute is constitutional since the experience requirement in the statute is rationally related to the state's objective in maintaining the quality of CPA's.³⁸

The North Carolina statute that prohibits advancements of money

29. 294 N.C. 120, 240 S.E.2d 406 (1978).

30. N.C. GEN. STAT. § 93-12(5) (Cum. Supp. 1977). The statute also requires that an applicant pass the CPA exam before being licensed.

31. *Id.* § 93-1(5) (1975).

32. 294 N.C. at 123, 240 S.E.2d at 409.

33. *Id.* at 124, 240 S.E.2d at 409.

34. *Id.*

35. *Id.* at 129, 240 S.E.2d at 412-13.

36. *Id.* at 127-28, 240 S.E.2d at 411.

37. *Id.* at 129-30, 240 S.E.2d at 413.

38. The court applied the same finding of a rational relationship between the statutory experience requirement and the state's desire to regulate the quality of CPA's in upholding the statute against Duggins' equal protection claim that the statute unreasonably discriminated between those persons with two years' experience with a CPA in the public practice and those without such experience. *Id.* at 130-33, 240 S.E.2d at 413-14.

to political candidates by a corporation, business, or union³⁹ was challenged by a public relations firm in *Louchheim, Eng & People, Inc. v. Carson*,⁴⁰ the first North Carolina case to interpret the corporate campaign contribution statute. Plaintiff had been hired by defendant candidate for state attorney general to carry on his media campaign and had purchased about \$22,000 worth of advertising.⁴¹ Plaintiff sued to collect the money after defendant had written a bad check for the amount.⁴² The North Carolina Court of Appeals agreed with defendant that the \$22,000 was an illegal campaign contribution under G.S. 163-278, which prohibits "any contribution or expenditure . . . in and on behalf of or in opposition to any candidate or political committee in any election or for any political purpose whatsoever,"⁴³ and so refused to allow plaintiff recovery.⁴⁴

Interpreting the statute as barring all credit transactions, plaintiff challenged the statute as an unreasonable infringement on the right to contract and carry on a lawful occupation.⁴⁵ The court in upholding the statute correctly stated that the money that plaintiff spent was clearly an advancement, which is specifically prohibited under the statutory definition of "contribution and expenditure."⁴⁶ Plaintiff argued that if its payments for advertising costs were prohibited under the statute, then all credit transactions between business and political candidates would be barred.⁴⁷ The court stated that if it construed the statute to prohibit all such credit transactions the statute might indeed

39. "[I]t shall be unlawful for any corporation, business entity, labor union, professional association or insurance company directly or indirectly:

(1) to make any contribution or expenditure (except a loan of money by a national or State bank made in accordance with the applicable banking laws and regulations and in the ordinary course of business) in aid or in behalf of or in opposition to any candidate or political committee in any election or for any political purpose whatsoever"

N.C. GEN. STAT. § 163-278.19(a)(1976).

40. 35 N.C. App. 299, 241 S.E.2d 401 (1978). For further discussion of this opinion, see this Survey, *Administrative Law: Campaign Finance*.

41. 35 N.C. App. at 301, 241 S.E.2d at 403.

42. *Id.*

43. N.C. GEN. STAT. § 163-278.19(a) (1976).

44. 35 N.C. App. at 304, 241 S.E.2d at 405.

45. *Id.* at 306, 241 S.E.2d at 406. Plaintiff attacked the restriction on the right to engage in business activity as violative of the fourteenth and fifth amendments to the United States Constitution, and the "law of the land" clause of the North Carolina Constitution, which has been interpreted to have the same meaning as the federal due process clause. N.C. CONST. art. I, § 19; see *State v. Collins*, 169 N.C. 323, 324, 84 S.E. 1049, 1050 (1915).

46. 35 N.C. App. at 307, 241 S.E.2d at 406. Contribution and expenditure are defined in N.C. GEN. STAT. § 163-278.6(6), (9) (1976) to include advertisements.

47. 35 N.C. App. at 306, 241 S.E.2d at 406.

be unconstitutional.⁴⁸ In the court's view, however, the advancement of money for an advertising campaign was clearly distinguishable from an "ordinary extension of credit to a client for services rendered,"⁴⁹ which is not barred by the statute. The court, however, does not provide a basis for making this distinction. Moreover, the language of the statute might well be construed otherwise to cover normal credit transactions. First, the definitions of "contribution" and "expenditure" in the statute include not only advancement, but also "any . . . transfer of funds, loan, payment, gift, pledge or subscription of money *or anything of value whatsoever*."⁵⁰ Additionally, an important policy behind the statute as articulated by the court is the prevention of any activity by a corporation that would "encourage favored treatment by an official once he is elected."⁵¹ Given the expansive inclusiveness of the definition of "expenditure" and the policy against businesses currying political favor, arguably the statute may prohibit any credit transactions with political candidates. Further, the definition of a contribution and expenditure goes on to say that "[t]hese terms include, without limitation, such contributions as labor or personal services."⁵² This language combined with a broad reading of the definition of contribution contradicts the court's finding that extensions of credit on personal services are not prohibited by the statute.⁵³ When the statute is so interpreted to prohibit all credit transactions between business and candidates, an interpretation supported by the language of the statute itself, the restriction on a plaintiff's right to contract and carry on a lawful business is not minimal; rather, in the court's words, this interpretation "might well involve unreasonable intrusions on constitutional rights."⁵⁴ Such a prohibition on credit transactions clearly restricts the ability of business to function and therefore may unconstitutionally infringe the right to carry on a lawful occupation.

2. Freedom of Contract

In *State ex rel. Utilities Commission v. Edmisten*,⁵⁵ the North Carolina Supreme Court considered plaintiffs' claims that an order of the

48. *Id.* at 306-07, 241 S.E.2d at 406.

49. *Id.* at 305, 241 S.E.2d at 405.

50. N.C. GEN. STAT. §§ 163-278.6(6), (9) (1976).

51. 35 N.C. App. at 304, 241 S.E.2d at 405.

52. N.C. GEN. STAT. § 163-278.6(6) (1976).

53. 35 N.C. App. at 305, 241 S.E.2d at 405.

54. *Id.* at 307, 241 S.E.2d at 406.

55. 294 N.C. 598, 242 S.E.2d 862 (1978).

State Utilities Commission that allowed natural gas companies to obtain direct rate increases to cover costs of natural gas exploration without a general ratemaking hearing was a violation of the due process clause and its state analogue, North Carolina's law of the land clause.⁵⁶ The attorney general, in attacking the granting of the rate increases, argued that the rate increases were forced investments that violated customers' freedom of contract.⁵⁷ Plaintiff relied on a 1974 North Carolina Supreme Court case, *Bulova Watch Co. v. Brand Distributors, Inc.*,⁵⁸ which held that protection of manufacturers of trademarked goods against price cutting and unauthorized use of the trademark was an insufficient benefit to the public to justify the infringement on the freedom to contract that resulted from the non-signer clause of the North Carolina Fair Trade Act.⁵⁹ The supreme court in *Bulova*, recognizing that the freedom to contract is a constitutionally protected right that can be infringed only on a showing of the furtherance of a legitimate state interest,⁶⁰ believed that the nonsigner clause added little protection for the manufacturer that the trademark laws did not already provide, and so the infringement on nonsigners' freedom to resell at their own prices was unjustifiable.⁶¹ Although the court in *Utilities Commission* agreed with plaintiff that the rate increase did constitute forced investment in gas exploration, it also decided that the public's need to be protected from gas shortages was crucial to the state's economy and individual well being and so, unlike *Bulova*, justified the infringement on the right to contract.⁶²

In another contract case, *Mazda Motors of America, Inc. v. Southwestern Motors, Inc.*,⁶³ the North Carolina Court of Appeals held that

56. *Id.* at 610, 242 S.E.2d at 870; see note 45 *supra*. The statute was also attacked as violative of the equal protection clause of the United States and North Carolina constitutions.

57. *Id.* at 611, 242 S.E.2d at 870.

58. 285 N.C. 467, 206 S.E.2d 141 (1974).

59. *Id.* at 475, 206 S.E.2d at 146. The nonsigner clause provided that selling a manufacturer's trademark goods at a price below his list price, in violation of a contract provision not to do so, is unfair competition, whether or not the person selling the goods below list price is a party to the contract. Law of March 22, 1937, ch. 350, § 6, 1937 N.C. Pub. Laws 683 (formerly codified at N.C. GEN. STAT. § 66-56 (1975)) (repealed 1975).

60. 285 N.C. at 478, 206 S.E.2d at 149. The court cited *Nebbia v. New York*, 291 U.S. 502 (1934), which held that a state could place a maximum and minimum price on the sale of a commodity (milk) when the economic welfare of the public required it.

61. The additional policy of fostering free competition by prohibiting manufacturers from controlling all resale prices may also have been present in *Bulova*. The fostering of competition in *Bulova* coincided with the protection of a competitor's right to contract, which was the stated basis for the court's decision. 285 N.C. at 478, 206 S.E.2d at 149.

62. 294 N.C. at 611, 242 S.E.2d at 870.

63. 36 N.C. App. 1, 243 S.E.2d 793 (1978), *aff'd in part, rev'd in part*, 296 N.C. 357 (1979).

a state statute requiring motor vehicle manufacturers or distributors to notify the Commissioner of Motor Vehicles before any attempt to revoke a dealer's franchise⁶⁴ did not unconstitutionally impair the obligations of contracts.⁶⁵ The court approved the state's interest in preventing the harm to the economy and the general public inherent in unilateral contracts of adhesion, which often result from unequal bargaining power between distributors and dealers.⁶⁶

The court of appeals adopted the approach taken by the United States Supreme Court⁶⁷ to determine whether the statute unreasonably impaired the obligations of contract. The test begins with a determination whether the statute involves a "disturbance of essential or core expectations arising from the particular type of contract."⁶⁸ Those expectations are not disturbed unless the statute so greatly discourages the making of such contracts as to amount to a taking without compensation in violation of due process.⁶⁹ Applying this test, the court reasoned that the restrictions imposed by G.S. 20-30(6),⁷⁰ requiring only sixty days notice to the Commissioner, did not so discourage franchise dealership contracts as to be a taking (of the financial benefits obtained from such contracts) in violation of due process.⁷¹ The court concluded that the restrictions imposed by the statute, because they did not restrict the right to contract to the extent of an unconstitutional taking, and because they advanced the state interest of protecting the public and dealers from the effects of contracts of adhesion, were reasonable restrictions on the obligation of contract.⁷²

3. License Revocation

In *In re Harris*,⁷³ the North Carolina Court of Appeals upheld against a void for vagueness challenge a North Carolina statute that provided for revocation of a driver's license for repeated violations of

64. N.C. GEN. STAT. § 20-305(6) (1978).

65. 36 N.C. App. at 10, 243 S.E.2d at 800; U.S. CONST. art. I, § 10, cl. 1.

66. 36 N.C. App. at 7, 243 S.E.2d at 798-99.

67. *City of Pittsburgh v. Alco Parking Corp.*, 417 U.S. 369 (1974) (city ordinance imposing 20% tax on gross receipts from nonresidential parking establishments held valid as not constituting a taking without compensation); *City of El Paso v. Simmons*, 379 U.S. 497 (1965) (statute providing for termination of land sales contracts for nonpayment of interest and limiting reinstatement right of purchaser held valid as advancing state interest in clarifying land titles).

68. 36 N.C. App. at 9-10, 243 S.E.2d at 800.

69. *Id.* at 10, 243 S.E.2d at 800.

70. N.C. GEN. STAT. § 20-305(6) (1978).

71. 36 N.C. App. at 10, 243 S.E. 2d at 800.

72. *Id.*

73. 37 N.C. App. 590, 246 S.E.2d at 532 (1978).

the liquor laws.⁷⁴ Petitioner's driver's license had been revoked after his third conviction for driving under the influence of alcohol.⁷⁵ He sought reinstatement of his license three years after his last D.U.I. conviction, but the Division of Motor Vehicles refused to reinstate the license because petitioner had been convicted of public drunkenness within those three years.⁷⁶ The Division construed the prohibition in G.S. 20-19(e)⁷⁷ against reissuance of a license within three years of a liquor law violation to include a conviction for public drunkenness.⁷⁸ The trial court held that "liquor laws" as used in G.S. 20-19(e) was unconstitutionally vague and overbroad.⁷⁹ The court of appeals reversed holding that the statute was not overbroad because it only prohibited conduct violative of liquor laws, conduct not constitutionally protected.⁸⁰

The court's analysis of petitioner's vagueness argument was cursory at best. After citing *Surplus Store, Inc. v. Hunter*,⁸¹ a North Carolina Supreme Court case, for the rule that a statute is unconstitutionally vague only if " 'men of common intelligence must necessarily guess at its meaning,' " ⁸² the court summarily held that the term was so clear "that no further discussion is necessary."⁸³ Nevertheless the court went on to discuss at length the question whether public drunkenness was a violation of the liquor laws, and based on the legislative intent as evidenced by the use of the expansive terms "motor vehicle laws," "liquor laws," and "drug laws" in G.S. 20-19(e), the court held that a conviction for public drunkenness was a violation of a "liquor law."⁸⁴

74. The statute provides that a license may be revoked because of a third or subsequent conviction for driving under the influence of alcohol or drugs. If such a revocation occurs due to a conviction within five years of a prior conviction, the revocation is permanent. Even if the revocation is permanent, a new license may be issued, if after three years from the date of revocation the licensee has not been convicted of a violation of a motor vehicle law, a drug law, or a liquor law. N.C. GEN. STAT. § 20-19(e) (1978).

75. *Id.* at 591, 246 S.E.2d at 533.

76. *Id.* The misdemeanor of public drunkenness is defined in Law of Feb. 13, 1897, ch. 57, 1897 N.C. Pub. Laws 109 (formerly codified as amended at N.C. GEN. STAT. § 14-335(a) (1969)) (repealed 1978).

77. N.C. GEN. STAT. § 20-19(e) (1978).

78. 37 N.C. App. at 595, 246 S.E.2d at 535.

79. *Id.* at 591, 246 S.E.2d at 533.

80. *Id.* at 593-94, 246 S.E.2d at 534.

81. *Id.* at 593, 246 S.E.2d at 534 (citing 257 N.C. 206, 125 S.E.2d 764 (1962)).

82. *Id.* (quoting 257 N.C. 206, 211, 125 S.E.2d 764, 768 (1962)).

83. *Id.*

84. *Id.* at 594-95, 246 S.E.2d at 534-35.

In another license revocation case, a doctor challenged for vagueness and overbreadth both the state statute under which his medical license was revoked and the order of the Board of Medical Examiners suspending the revocation. *In re Wilkins*, 294 N.C. 528, 242 S.E.2d 829 (1978).

4. "Peeping Tom" Statute

The North Carolina statute that makes it a misdemeanor to "peep secretly into any room occupied by a female person,"⁸⁵ popularly known as the "Peeping Tom" statute, was attacked as unconstitutionally vague and overbroad and violative of due process in *In re Banks*.⁸⁶ The United States Supreme Court in *Wainwright v. Stone*⁸⁷ had held that the Florida "crime against nature" statute was not unconstitutionally vague when read against a background of the common law and prior state court decisions giving crime against nature a specific narrow definition.⁸⁸ Based on *Wainwright*, the supreme court stated that the words of the statute were ambiguous, so they must be read in light of judicial construction given them in prior cases and in light of legislative intent.⁸⁹ The court, relying on *State v. Banks*,⁹⁰ which held that "to peep secretly" connoted spying to invade one's privacy, interpreted the terms "peep secretly" to prohibit "the wrongful spying into a room upon a female with the intent of violating the female's legitimate expectation of privacy."⁹¹ The statute therefore was sufficiently definite, when read in light of prior cases, to give defendants fair notice of the prohibited conduct.⁹² The overbreadth argument also failed because the statute, under the court's narrowing construction, does not prohibit any legitimate, constitutionally protected conduct, such as an unintentional glance into a window.⁹³

Pursuant to Law of Feb. 3, 1933, ch. 32, 1933 N.C. Sess. Laws 25 (formerly codified at N.C. GEN. STAT. § 90-14 (1975)) (repealed 1975), which provides for revocation of a physician's license for "unprofessional or dishonorable conduct unworthy of, and affecting, the practice of his profession," respondent's license was revoked after he was convicted of preparing a false and fraudulent medical bill and physician's report. 294 N.C. at 530, 242 S.E.2d at 830-31. The Board suspended the revocation on condition that respondent "conduct his practice of medicine in accordance with proper professional and ethical standards." *Id.* at 530-31, 242 S.E.2d at 831. Respondent was later charged by the Board with prescribing highly dangerous drugs to strangers without examining them first, and the Board therefore withdrew the suspension and revoked respondent's license. *Id.* at 532, 242 S.E.2d at 831-32. Stating that the proper test for vagueness is "whether a reasonably intelligent member of the profession would understand that the conduct in question is forbidden," the supreme court concluded that respondent's conduct was clearly unprofessional and unethical; therefore both the statute and the order to the Board were constitutional as applied to respondent. *Id.* at 548-49, 242 S.E.2d at 841.

85. 85 N.C. GEN. STAT. § 14-202 (1969).

86. 295 N.C. 236, 244 S.E.2d 386 (1978).

87. 414 U.S. 21 (1973).

88. *Id.* at 22-23.

89. 295 N.C. at 240-41, 244 S.E.2d at 389.

90. 263 N.C. 784, 140 S.E.2d 318 (1965).

91. 295 N.C. at 242, 244 S.E.2d at 390.

92. *Id.*

93. *Id.* at 243-44, 244 S.E.2d at 391.

The North Carolina Court of Appeals struck down another criminal statute for vagueness in

E. North Carolina Constitution

1. Coastal Area Management Act

In *Adams v. Department of Natural and Economic Resources*⁹⁴ plaintiff claimed that the Coastal Area Management Act of 1974 (CAMA)⁹⁵ was a local law and, as such, was prohibited by the North Carolina Constitution, which provides that "[t]he General Assembly shall not enact any local, private, or special act or resolution" relating to certain subjects, including trade, health, sanitation and abatement of nuisances.⁹⁶ The Act provides for the Coastal Resources Commission to promulgate guidelines, oversee land use plans adopted by each county in the coastal area, designate special areas of environmental concern and issue special use permits for those areas, with the objective of protecting and preserving the delicate, unique ecosystem of the coastal area.

The Coastal Resources Commission had designated an "interim" area of environmental concern, that limited plaintiff's use of his land.⁹⁷ Plaintiff argued that the North Carolina Constitution's prohibition against local laws prohibited statutes that are limited in geographical coverage without any legitimate reason for the limitation.⁹⁸ Arguing that the coastal area of North Carolina is no more unique in terms of its need for environmental protection and land use control than is any other area of the state, plaintiff concluded that the statute was a prohibited local law.⁹⁹

State v. Sanders, 37 N.C. App. 53, 245 S.E.2d 397 (1978). Sanders was convicted under N.C. GEN. STAT. § 14-186 (1969) for occupying a motel room for "immoral purposes." Because § 14-186 had received no limiting construction that defined "immoral purposes" to be illicit sexual intercourse as the state argued, the statute was unconstitutionally vague. 37 N.C. App. at 54-55, 245 S.E.2d at 398.

In another due process case, a federal district court held in *Fowler v. Williamson*, 448 F. Supp. 497 (W.D.N.C. 1978), that a high school student had no property interest in participation in a graduation ceremony. The court, finding no North Carolina law on whether such an interest was a property right, held that because plaintiff was not denied an education or even a diploma, but only participation in a ceremony (due to violation of the school dress code), he was not deprived of property in violation of due process. *Id.* at 502.

94. 295 N.C. 683, 249 S.E.2d 402 (1978).

95. Ch. 1284, 1973 Sess. Laws, 2d Sess. 1974, 463 (codified at N.C. GEN. STAT. § 113A-100 to -128 (1975 & Cum. Supp. 1977)).

96. N.C. CONST. art. II, § 24. Plaintiffs also claimed that the statute violated the U.S. CONST. amend. IV prohibition against unreasonable searches and seizures. 295 N.C. at 705, 249 S.E.2d at 415. For a discussion of plaintiff's claim that the statutory authorization for the promulgation of guidelines by the Coastal Resources Commission was a prohibited delegation of legislative authority, see this Survey, *Administrative Law: Coastal Area Management Act*.

97. 295 N.C. at 703, 249 S.E.2d at 414.

98. *Id.* at 691, 249 S.E.2d at 407.

99. *Id.*

The supreme court disagreed, citing *McIntyre v. Clarkson*,¹⁰⁰ which held that a North Carolina statute that provided for appointment procedure for justices of the peace in twenty-eight North Carolina counties was invalid as local legislation.¹⁰¹ The court in *McIntyre* stated that a law is "local" if "the persons or things subject to the law are not reasonably different from those excluded."¹⁰² The court in *Adams* reasoned that the coastal counties of North Carolina are sufficiently different from the other counties to warrant special attention.¹⁰³

Justice Copeland in dissent took issue with the majority's finding of a unique need of the coastal area's ecosystem for environmental protection.¹⁰⁴ He saw the Act as designed to regulate land use and not to protect the special attributes of the coastal environment.¹⁰⁵ In arguing that the Act was a prohibited local law because its stated objectives applied to all of North Carolina, Justice Copeland cited language in the proposed 1973 Mountain Area Management Act,¹⁰⁶ which was rejected by the 1973 General Assembly, that urged uniqueness of the state's mountains in much the same language as the CAMA uses in describing the North Carolina coast.¹⁰⁷ Because the state's coast is no more in need of protection than the mountains, the dissent concluded, the Act was unconstitutional local legislation.¹⁰⁸

In rejecting plaintiff's argument that the classification of the coastal area as distinct from the mountains and piedmont was unreasonable, the court seems merely to assume that the coastal counties have a special need for protection of the environment. The court says that once the class to which the statute applies is found to warrant special attention, the existence of other areas that also could be included is immaterial to the statute's constitutionality.¹⁰⁹ Plaintiff's argument, however, was not that other areas should also be included under the

100. 254 N.C. 510, 119 S.E.2d 888 (1961).

101. *Id.* at 525, 119 S.E.2d at 899.

102. *Id.* at 518, 119 S.E.2d at 894 (quoting Cloe & Marcus, *Special and Local Legislation*, 24 Ky. L.J. 364 (1935-1936)).

103. 295 N.C. at 691-93, 249 S.E.2d at 407-08.

104. *Id.* at 707-08, 249 S.E.2d at 416-17 (dissenting opinion).

105. *Id.* at 707, 249 S.E.2d at 416.

106. S. 973, N.C. Gen. Assembly, 1973 Sess. (proposed N.C. GEN. STAT. § 113A-137).

107. 295 N.C. at 707-08, 249 S.E.2d at 416-17 (dissenting opinion).

108. *Id.* at 707-09, 249 S.E.2d at 416-17.

109. *Id.* at 693, 249 S.E.2d at 408. "[T]here is no constitutional requirement that a regulation, in other respects permissible, must reach every class to which it might be applied—that the legislature must be held rigidly to the choice of regulating all or none. . . . It is enough that the present statute strikes at the end where it is felt, and reaches the class of cases where it most frequently occurs." *Id.* (quoting *Silver v. Silver*, 280 U.S. 117, 123-24 (1929)).

Act. Plaintiff's attack was directed at the reasonableness of the Act's classification of the coastal region as an area warranting special attention. A statute may "classify conditions, persons, places and things, and classification does not render a statute "local" if the classification is reasonable and based on a rational difference of situation and condition." ¹¹⁰ Admittedly the coastal area is distinct from the mountains and piedmont in that the valuable resources in the coastal area are in major respects of a different kind than those in the mountains.¹¹¹ The supreme court, however, did not show why the coastal resources, all of which are subject to pressures from increases in population and development,¹¹² are more in need of protection than the mountain resources. Such a comparison is necessary to provide a convincing basis for classification of the coastal area as unique within the state. Instead, such a comparison might show that the resources of the mountains of North Carolina are as valuable and are subject to the same pressures from development in the area as the coastal area.¹¹³ The resources such as undeveloped land and fresh, unpolluted water, which the CAMA states are to be protected, are present and in need of protection throughout the state; arguably therefore, the CAMA is limited to an area without a rational basis for the limitation and should be declared unconstitutional local legislation.

2. Taxation

Taxpayer in *Hughey v. Cloniger*¹¹⁴ sought to enjoin the use of public funds appropriated by the General Assembly for the use of a school for dyslexic children in Gaston County.¹¹⁵ The school was operated by a nonprofit corporation.¹¹⁶ Taxpayer claimed that payments of public revenues to a private corporation, regardless of the ultimate benevolent purpose to which the money is put, is not a public use and violates the North Carolina Constitution.¹¹⁷

The court of appeals stated, relying on *Stanley v. Department of*

110. *Id.* (quoting *High Point Surplus Co. v. Pleasants*, 264 N.C. 650, 656, 142 S.E.2d 697, 702 (1969)).

111. *Id.* at 692-93, 707, 249 S.E.2d at 408, 416.

112. *Id.*

113. 295 N.C. at 707-08, 249 S.E.2d at 416-17.

114. 37 N.C. App. 107, 245 S.E.2d 543, *cert. granted*, 295 N.C. 734, 248 S.E.2d 863 (1978).

115. *Id.*, 245 S.E.2d at 544.

116. *Id.* at 108, 245 S.E.2d at 545.

117. *Id.* at 107, 245 S.E.2d at 544; see N.C. CONST. art. V, § 2(1) (power of taxation shall be exercised for "public purpose" only).

Conservation & Development,¹¹⁸ which invalidated a North Carolina statute that authorized the creation of county agencies to finance pollution control facilities for private industries by tax exempt bonds,¹¹⁹ that public use is determined not merely by the benevolent purposes to which the money is put, but also by the means of attaining those purposes.¹²⁰ Because some funds were going to the corporation to operate the school and not only to pay the tuition of the children, the monies were not going to a public use.¹²¹ The court upheld the statute under which the funds were appropriated;¹²² however, because appropriation was not for a public use, it was not made in accordance with the statute.¹²³

EDWARD L. BALL

V. CRIMINAL LAW

A. *Post-Conviction Relief*

In *Mullaney v. Wilbur*,¹ the United States Supreme Court held that due process requires the State "to prove beyond a reasonable doubt the absence of the heat of passion on sudden provocation when the issue is properly presented in a homicide case."² This result invalidated North Carolina's use of the presumptions of unlawfulness and malice arising upon proof by the State of an intentional killing that had effectively shifted the burden of disproving these presumed elements to the defendant.³ Two years later, in *Hankerson v. North Carolina*,⁴ the United

118. 284 N.C. 15, 199 S.E.2d 641 (1973).

119. *Id.* at 41, 199 S.E.2d at 658.

120. 37 N.C. App. at 112-13, 245 S.E.2d at 547.

121. *Id.*

122. N.C. GEN. STAT. §§ 159-7 to -40 (1976 & Supp. 1977).

123. 37 N.C. App. at 113, 245 S.E.2d at 548.

1. 421 U.S. 684 (1975).

2. *Id.* at 704.

3. In *State v. Hankerson*, 288 N.C. 632, 220 S.E.2d 575 (1975), *rev'd*, 432 U.S. 233 (1977), the North Carolina Supreme Court ruled that, in light of *Mullaney*, the due process clause of the fourteenth amendment prohibited the use of the state's "long-standing rules in homicide cases that a defendant in order to rebut the presumption of malice must prove to the satisfaction of the jury that he killed in the heat of a sudden passion and to rebut the presumption of unlawfulness, that he killed in self defense." *Id.* at 643, 220 S.E.2d at 584. The court declined, however, to give retroactive effect to *Mullaney*. *Id.*

4. 432 U.S. 233 (1977).

States Supreme Court ruled that the holding in *Mullaney* applied retroactively.⁵ The *Hankerson* Court, however, indicated in a footnote that a state may limit the retroactivity of *Mullaney* by the use of the normal state procedural rule that failure to object to an erroneous jury instruction is a waiver of that error.⁶ In applying this limit on *Mullaney*'s retroactivity to collateral attacks on convictions, the North Carolina Court of Appeals and the United States District Court for the Eastern District of North Carolina have adopted different interpretations of this footnote.

Petitioner in *State v. Abernathy*⁷ applied for post-conviction relief from his 1974 conviction of second degree murder. The trial court found the waiver rule of footnote eight in *Hankerson* inapplicable under North Carolina appellate procedure and ordered a new trial.⁸ The North Carolina Court of Appeals reversed, holding that when a defendant could have challenged the jury charge respecting the proof burden on direct appeal and did not, he was not entitled to attack his conviction on that ground in a post-conviction collateral proceeding.⁹ The court based its decision on previous holdings that the Post Conviction Hearing Act¹⁰ does not provide a substitute for appeal and is available only for raising matters that factors beyond the defendant's

5. *Id.* at 240. This decision raised the possibility of the release of numerous convicted murderers from the North Carolina prisons due to improper allocation of the burden of proof at their trials.

6. The Court stated:

Moreover, we are not persuaded that the impact on the administration of justice in those States that utilize the sort of burden-shifting presumptions involved in this case will be as devastating as respondent asserts. If the validity of such burden-shifting presumptions were as well settled in the States that have them as respondent asserts, then it is unlikely that prior to *Mullaney* many defense lawyers made appropriate objections to jury instructions incorporating those presumptions The North Carolina Supreme Court passed on the validity of the instructions anyway. The States, if they wish, may be able to insulate past convictions by enforcing the normal and valid rule that failure to object to a jury instruction is a waiver of any claim of error.

Id. at 244 n.8 (citing FED. R. CRIM. P. 30).

7. 36 N.C. App. 527, 244 S.E.2d 696, *cert. denied*, 295 N.C. 552 (1978). The basis of Abernathy's claim was that the trial judge erroneously placed upon him the burden of proving self defense and of disproving malice.

8. *Id.* at 528, 244 S.E.2d at 697. The trial court ruled footnote eight inapplicable because North Carolina does not have the contemporaneous objection rule described by the Supreme Court in the footnote.

9. *Id.* at 531, 244 S.E.2d at 698.

10. *Abernathy* was decided under the old Post-Conviction Hearing Act, Law of Apr. 14, 1951, ch. 1083, § 1, 1951 N.C. Sess. Laws 1085 (formerly codified at N.C. GEN. STAT. §§ 15-217 to -222) (repealed 1977).

control prevented him from claiming earlier.¹¹

The decision in *Abernathy* is consistent with the North Carolina Supreme Court's ruling in a group of cases decided after *Hankerson*. In those cases the court held that failure to raise on appeal the error in the trial court's instructions resulted in a waiver of that claim of error.¹² The effect of these cases is that a defendant is foreclosed from both direct and collateral attack on his conviction in the state courts unless he foresaw the *Mullaney* decision and preserved the error on appeal. Relief in federal court may be available, however, in light of the recent decision of the United States District Court for the Eastern District of North Carolina in *Cole v. Stevenson*.¹³

In *Cole*, petitioner sought federal habeas corpus relief from his second degree murder conviction on the ground that the trial judge erroneously placed on him the burden of proving self defense and the absence of malice.¹⁴ The State argued that, according to *Hankerson's* footnote eight, petitioner's procedural default in failing to raise the issue of the trial judge's instructions at any time during the original appeals period barred him from raising that issue on federal habeas corpus.¹⁵ In rejecting this contention the court narrowly construed the reach of footnote eight. The court determined that North Carolina does not require the objection at trial described in footnote eight and held "if petitioner was not obligated to object at trial and a constitutional right (unacknowledged during his first appeals period) was retroactively applied to [his] case," there was no reason to foreclose federal habeas review because such a proceeding is independent of foreclosure

11. 36 N.C. App. at 531, 244 S.E.2d at 698; see *State v. White*, 274 N.C. 220, 162 S.E.2d 473 (1968); *Branch v. State*, 269 N.C. 642, 153 S.E.2d 343 (1967); *State v. Graves*, 251 N.C. 550, 112 S.E.2d 85 (1960); *State v. Wheeler*, 249 N.C. 187, 105 S.E.2d 615 (1958); *State v. Cruse*, 238 N.C. 53, 76 S.E.2d 320 (1953); *Miller v. State*, 237 N.C. 29, 74 S.E.2d 513 (1953); 4 STRONG'S NORTH CAROLINA INDEX 3d *Criminal Law* § 181, at 911-12 (1976).

12. In *State v. Brower*, 293 N.C. 259, 243 S.E.2d 143 (1977); *State v. Crowder*, 293 N.C. 259, 243 S.E.2d 143 (1977); *State v. Jackson*, 293 N.C. 260, 247 S.E.2d 234 (1977); *State v. May*, 293 N.C. 261, 247 S.E.2d 234 (1977); and *State v. Riddick*, 293 N.C. 261, 247 S.E.2d 234 (1977), the North Carolina Supreme Court in denying rehearing petitions ruled that the defendants had waived their right to claim as error the failure of the trial judge properly to place the burden of proving the absence of self defense or the absence of heat of passion when the defendants did not assign that error on appeal. In two cases, however, petitioners were granted new trials by the court when they had properly raised the error in the instructions in the original appeals from their convictions. *State v. Sparks*, 293 N.C. 262, 248 S.E.2d 339 (1977); *State v. Wetmore*, 293 N.C. 262, 248 S.E.2d 338 (1977).

13. 447 F. Supp. 1268 (E.D.N.C. 1978).

14. *Id.* at 1269.

15. *Id.* at 1272. This was the argument accepted by the North Carolina Court of Appeals in *Abernathy*.

in state courts by state procedural default.¹⁶

In addition, the court went on to hold that the recent United States Supreme Court decision in *Wainwright v. Sykes*¹⁷ dictated that, even if North Carolina had a contemporaneous objection rule, defendant Cole would not be denied his right to federal habeas corpus review.¹⁸ In *Wainwright*, the United States Supreme Court had held a state procedural default may be an adequate and independent state procedural ground that would bar federal habeas corpus review absent a showing of cause for the default and actual prejudice to petitioner's rights.¹⁹ Applying *Wainwright*, the *Cole* court concluded that this petitioner met the cause-prejudice test. The "cause" element was met because no attorney would have considered objecting to an instruction that had been upheld for over one hundred years. The "prejudice" element was satisfied by defendant having to bear the burden of negating malice and proving he acted in self defense.²⁰

In finding *Wainwright* applicable, the district court apparently disregarded a decision by the United States Court of Appeals for the Fourth Circuit in *Frazier v. Weatherholz*²¹ rendered less than a month before *Cole*.²² The court of appeals in *Frazier* held that federal habeas review of a petitioner's *Mullaney* claim was barred by *Wainwright* and *Hankerson's* footnote eight when he failed to comply with Virginia's contemporaneous objection rule.²³ Although the court of appeals did

16. *Id.*

17. 433 U.S. 72 (1977).

18. 447 F. Supp. at 1272-74.

19. 433 U.S. at 87. Defendant in *Wainwright* had received federal habeas corpus relief from his state conviction because certain inculpatory statements made by him were illegally obtained and used at his trial. The Florida courts had refused to review this alleged error because of defendant's failure to comply with Florida's contemporaneous objection rule. The United States Supreme Court considered the issue in the case to be the adequacy of a state procedural ground to bar federal habeas corpus review. In reversing, the Supreme Court effectively overruled the interpretation of *Fay v. Noia*, 372 U.S. 391 (1963), that would allow federal review of state cases limited only by a showing of a deliberate by-pass or knowing waiver of the state procedural rule. The Supreme Court explicitly left the determination of the precise content of the cause-prejudice test to case by case development. At least one commentator has interpreted this decision and *Hankerson's* footnote eight as barring federal review of a *Mullaney*-based claim when the defendant has failed to comply with a state contemporaneous objection rule with respect to jury instructions. Spritzer, *Criminal Waiver, Procedural Default and the Burger Court*, 126 U. PA. L. REV. 473, 508 n.181 (1978).

20. 447 F. Supp. at 1272-74.

21. 572 F.2d 994 (4th Cir. 1978).

22. The decision in *Frazier* was handed down on February 27, 1978, 572 F.2d at 994; the *Cole* decision was rendered on March 14, 1978, 447 F. Supp. at 1268.

23. 572 F.2d at 997-98. Petitioner in *Frazier* had failed to object to the trial judge's instructions on the burden of proof at his murder trial. His *Mullaney*-based petition was denied review by the Virginia state courts on both direct and collateral attack on grounds that he failed to com-

not expressly apply the cause-prejudice test, the implication of the decision is that failure to anticipate the unconstitutionality of the jury instructions is not sufficient cause under *Wainwright* and *Hankerson*.²⁴ Such a reading would invalidate the alternative holding in *Cole*. Relief in federal courts by state prisoners would then rest on the validity of the *Cole* court's determination that footnote eight is inapplicable because North Carolina does not have a contemporaneous objection rule.²⁵

Although *Abernathy* would seem to foreclose relief in state court, leaving recourse only to the federal courts under *Cole*, the recent adoption of a new post-conviction relief procedure in North Carolina²⁶ provides a basis for state relief and may require that *Abernathy* be limited to actions brought under the old post-conviction relief Act.²⁷ The new post-trial relief statute, effective July 1, 1978, appears to overrule the holding in previous post-conviction decisions that a change in the law, although retroactive in application, is not a ground for post-conviction

ply with the Virginia contemporaneous objection rule. Subsequently, a petition for habeas corpus relief was reviewed by a federal district court and relief granted on the basis of the *Mullaney* claim. The court of appeals, in reversing, never reached the merits of the claim, holding review by the federal district court barred by *Hankerson* and *Wainwright*.

24. See Spritzer, *supra* note 19, at 508-09.

25. The absence of a contemporaneous objection rule in North Carolina was admitted by the *Abernathy* court: in reaching its decision the court of appeals noted North Carolina appellate procedure does "not require [that] an objection to [a jury instruction] be made at the time of the trial to preserve the exception." 36 N.C. App. at 531, 244 S.E.2d at 698 (citing N.C.R. APP. P. 10(b)(2)). In *State v. Watson*, 37 N.C. App. 399, 246 S.E.2d 25 (1978), the court of appeals followed *Abernathy* and reversed a trial court's grant of post conviction relief for a *Mullaney* claim. The court acknowledged that North Carolina does not adhere to the precise rule referenced in *Hankerson's* footnote eight, but held the analogous North Carolina rule recognizes the same principle, *i.e.*, a failure to take some affirmative step to preserve the error on appeal results in a waiver. *Id.* at 405, 246 S.E.2d at 28.

The new North Carolina appellate review statute permits review regardless of the absence of an objection or a motion at the trial level, based on the following grounds:

(7) The conviction was obtained in violation of the Constitution of the United States or the Constitution of North Carolina.

(13) Error of law in the charge to the jury.

(19) A significant change in law, either substantive or procedural, applies to the proceedings leading to the defendant's conviction or sentence, and retroactive application of the changed legal standard is required.

N.C. GEN. STAT. § 15A-1446(d)(7), (13), (19) (1978).

26. N.C. GEN. STAT. §§ 15A-1411 to -1422 (1978).

27. The old Post-Conviction Hearing Act, Law of Apr. 14, 1951, ch. 1083, § 1, 1951 N.C. Sess. Laws 1085 (formerly codified as amended at N.C. GEN. STAT. §§ 15-217 to -222), was repealed in 1977 by the new Act.

relief if not raised as error either at trial or on direct appeal.²⁸ The statute lists several grounds for collateral relief that may be asserted without time limitation. The two relevant to a *Mullaney*-based claim are:

(3) The conviction was obtained in violation of the Constitution of the United States or the Constitution of North Carolina.

(7) There has been a significant change in the law, either substantive or procedural, applied in the proceedings leading to the defendant's conviction or sentence, and retroactive application of the changed legal standard is required.²⁹

The statute appears further to excuse the waiver of a claim of error for failure to bring it up on direct appeal by allowing the court "in the interest of justice and for good cause shown" to grant a post-conviction motion if meritorious.³⁰ This discretion in the state court should allow it to find good cause to excuse a waiver by procedural default of a *Mullaney* claim because the defense counsel could not be expected to anticipate the unconstitutionality of the trial judge's instructions. Thus, it appears that the legislature has given the state courts the opportunity to avoid *Abernathy* and to hear *Mullaney*-based claims on collateral attack notwithstanding that the error was not brought up on direct appeal. Such state court review seems particularly reasonable in light of the federal courts' willingness, as in *Cole*, to grant habeas corpus relief if the state refuses to review the *Mullaney* claim.³¹

B. Kidnapping³²

In 1975 the North Carolina General Assembly enacted this state's

28. See note 12 and accompanying text *supra*. N.C. GEN. STAT. § 15A-1415(b)(7) (1978) specifically states that a change in the law may be a ground for post-conviction relief.

29. N.C. GEN. STAT. § 15A-1415(b)(3), (7) (1978).

30. *Id.* § 15A-1419(b).

31. See *Reeves v. Reed*, 452 F. Supp. 783 (W.D.N.C. 1978), in which the United States District Court for the Western District of North Carolina granted habeas corpus relief on a *Mullaney*-based claim similar to the one in *Cole*.

32. In a related area the court of appeals, in *State v. Walker*, 35 N.C. App. 182, 241 S.E.2d 89 (1978), held that in the absence of a custody order in favor of the mother, neither the father of a child, nor anyone acting with his consent, can be guilty of child abduction. In this case defendant agreed to help his son abduct the son's two children, who had been living with their mother since the couple was divorced. While carrying out the abduction, the two men discovered that one of the children they had taken was not defendant's grandchild and returned her. Because all the evidence in this case pointed to defendant acting in concert with his son, defendant could not be found guilty of abducting his grandson. See *State v. Burnett*, 142 N.C. 577, 55 S.E. 72 (1906). Further, if defendant agreed to abduct his son's daughter, but abducted the wrong child because of a mistaken belief about the identity of the child he abducted, criminal intent could be negated. Such mistake of fact could negate defendant's criminal intent provided that the mistake under

first statutory definition of kidnapping.³³ The North Carolina Court of Appeals subsequently determined that the statute presented constitutional problems by potentially permitting the conviction of a defendant twice for the same offense.³⁴ In 1978, the North Carolina Supreme Court rejected two distinct challenges to the statute based primarily on the contention that the statute permitted multiple convictions for the same offense.

In *State v. Fulcher*,³⁵ the court addressed that portion of G.S. 14-39³⁶ providing that anyone who unlawfully restrains, confines, or removes another for one of three specified purposes, including facilitating the commission of a felony, commits the crime of kidnapping. Relying on the intent of the legislature in enacting G.S. 14-39, the court construed this provision to require no substantial restraint, confinement or removal to constitute the offense.³⁷ The court of appeals had proposed that substantiality be required in order to avoid the potential due process and equal protection problems of subjecting a defendant to punishment for two crimes, kidnapping and the underlying felony, when only one had been committed.³⁸ The supreme court determined that because it is not unconstitutional to convict a defendant for two

which the defendant was acting was made in good faith and with due care. See *State v. Powell*, 141 N.C. 780, 53 S.E. 515 (1906); *Dominguez v. State*, 90 Tex. Crim. 92, 234 S.W. 79 (1921). Consequently, in such a case, an instruction to the jury on the requisite criminal intent necessary to sustain a finding of guilty of the offense of child abduction is required.

33. N.C. GEN. STAT. § 14-39 (Cum. Supp. 1977) provides in pertinent part:

(a) Any person who shall unlawfully confine, restrain, or remove from one place to another, any other person 16 years of age or over without the consent of such person, or any other person under the age of 16 years without the consent of a parent or legal custodian of such person, shall be guilty of kidnapping if such confinement, restraint or removal is for the purpose of:

- (1) Holding such other person for ransom or as a hostage or using such other person as a shield; or
- (2) Facilitating the commission of any felony or facilitating flight of any person following the commission of a felony; or
- (3) Doing serious bodily harm to or terrorizing the person so confined, restrained or removed or any other person.

(b) Any person convicted of kidnapping shall be guilty of a felony and shall be punished by imprisonment for not less than 25 years nor more than life. If the person kidnapped, as defined in subsection (a), was released by the defendant in a safe place and had not been sexually assaulted or seriously injured, the person so convicted shall be punished by imprisonment for not more than 25 years, or by a fine of not more than ten thousand dollars (\$10,000), or both, in the discretion of the court.

34. See *State v. Gunther*, 38 N.C. App. 279, 248 S.E.2d 97 (1978); *State v. Fulcher*, 34 N.C. App. 233, 237 S.E.2d 909 (1977), *aff'd*, 294 N.C. 503, 243 S.E.2d 338 (1978).

35. 294 N.C. 503, 243 S.E.2d 338 (1978).

36. N.C. GEN. STAT. § 14-39 (Cum. Supp. 1977).

37. 294 N.C. at 522, 243 S.E.2d at 351.

38. 34 N.C. App. 233, 240, 237 S.E.2d 909, 914 (1977), *aff'd*, 294 N.C. 503, 243 S.E.2d 338 (1978).

distinct and separate crimes even if they grow out of the same act or transaction, the statute was not unconstitutional on its face.³⁹

Defendant in *Fulcher* forced his way into a motel room occupied by two women, and after making them lie down, he bound their wrists and forced them to have oral sex with him.⁴⁰ Defendant was convicted of two counts of crime against nature and two counts of kidnapping.⁴¹ On appeal he challenged G.S. 14-39 as violative of the due process and equal protection clauses of the United States Constitution on the ground that the statute permitted his conviction of two crimes when only one had been committed. By finding that each victim was bound and restrained for a substantial period of time, and that the restraint was not merely incidental to the commission of the crime against nature because the restraint was applied to one victim while the crime against nature was committed upon the other, the court of appeals found two distinct crimes.⁴² Nevertheless, to avoid future constitutional challenges, the court of appeals, relying on prior North Carolina decisions⁴³ and the Model Penal Code⁴⁴ for support, concluded that the statute had to be construed to require substantiality, in terms of time or distance, as an essential element of kidnapping.⁴⁵

The supreme court rejected the court of appeals interpretation on

39. 294 N.C. at 523-25, 243 S.E.2d at 351-52.

40. 34 N.C. App. 233, 234, 237 S.E.2d 909, 910-11 (1977).

41. Defendant was sentenced to two consecutive 10 year sentences on the crime against nature charges, to run concurrently with a 28-40 year sentence on the consolidated kidnapping charge. *Id.* at 235, 237 S.E.2d at 910-11.

42. *Id.* at 240-41, 237 S.E.2d at 914-15; see *Survey of Developments in North Carolina Law*, 1977, 56 N.C.L. REV. 843, 965-70 (1978).

43. See *State v. Roberts*, 286 N.C. 265, 210 S.E.2d 396 (1974); *State v. Dix*, 282 N.C. 490, 193 S.E.2d 897 (1973).

44. MODEL PENAL CODE § 212.1 (1962) provides in pertinent part:

A person is guilty of kidnapping if he unlawfully removes another from his place of residence or business, or a substantial distance from the vicinity where he is found, or if he unlawfully confines another for a substantial period in a place of isolation, with any of the following purposes:

- (a) to hold for ransom or reward, or as shield or hostage; or
- (b) to facilitate commission of any felony or flight thereafter; or
- (c) to inflict bodily injury on or to terrorize the victim or another; or
- (d) to interfere with the performance of any governmental or political function.

Kidnapping is a felony of the first degree unless the actor voluntarily releases the victim alive and in a safe place prior to trial, in which case it is a felony of the second degree. A removal or confinement is unlawful within the meaning of this Section if it is accomplished by force, threat or deception

The Model Penal Code is similar to the North Carolina statute, except that it expressly qualifies both "asportation" and "confinement" with "substantial."

45. 34 N.C. App. 233, 239-40, 237 S.E.2d 909, 914 (1977). The court of appeals stated that, in future trials, the judge must instruct that any restraint, confinement or removal must be substantial, and not merely incidental to the commission of another crime. *Id.* at 241, 237 S.E.2d at 915.

the ground that G.S. 14-39 had been enacted to overrule statutorily the prior North Carolina decisions requiring substantiality as an element of kidnapping.⁴⁶ In *State v. Dix*,⁴⁷ the court had rejected the former rule that any carrying away is sufficient⁴⁸ and required more than a mere technical asportation.⁴⁹ In *State v. Roberts*,⁵⁰ similarly, the court had required a holding of the victim for "some appreciable period of time" and a carrying away "beyond the immediate vicinity."⁵¹ The *Fulcher* court concluded that the legislature's intent in passing G.S. 14-39 was to make "resort to a tape measure or a stop watch unnecessary in determining whether the crime of kidnapping has been committed."⁵²

Addressing the double jeopardy problem, the court noted that some restraint is an inherent, inevitable feature of certain felonies.⁵³ This restraint, in contrast to restraint that is "separate and apart"⁵⁴ from the commission of the other felony, cannot be punished as kidnapping.⁵⁵ The court acknowledged, however, that two or more punishable offenses may grow out of the same course of action, as when one offense is committed with the intent to commit the other and is

46. 294 N.C. at 522, 243 S.E.2d at 351.

It is . . . clear that the Legislature rejected our determinations in *State v. Dix* . . . and in *State v. Roberts*, . . . to the effect that, where the State relies upon asportation of the victim to establish a kidnapping, the asportation must be for a substantial distance and where the State relies upon "dominion and control," i.e., "confinement" or "restraint," such must continue "for some appreciable period of time."

Id.

47. 282 N.C. 490, 193 S.E.2d 897 (1973).

48. See, e.g., *State v. Inland*, 278 N.C. 42, 178 S.E.2d 577 (1971). The *Fulcher* court also noted that the legislature rejected its decision in *Inland* that there must be both detention and asportation. No asportation is required now when there exists the requisite confinement or restraint. 294 N.C. at 522, 243 S.E.2d at 351.

49. 282 N.C. at 501-02, 193 S.E.2d at 904. In *Dix*, the court reversed the kidnapping conviction of a defendant who took a jailer 62 feet through a jail at gunpoint and locked him in a cell. The court held the asportation and detention were only incidental to the primary offense.

50. 286 N.C. 265, 210 S.E.2d 396 (1974).

51. *Id.* at 277, 210 S.E.2d at 404. In *Roberts*, the court reversed the kidnapping conviction of a defendant who had dragged a seven year old girl 80-90 feet.

52. 294 N.C. at 522, 243 S.E.2d at 351.

53. *Id.* at 523, 243 S.E.2d at 351 (suggesting, e.g., forcible rape and armed robbery).

54. *Id.* In *State v. Vert*, 39 N.C. App. 26, 249 S.E.2d 476 (1978), the court of appeals defined when, under *Fulcher*, the crimes are "separate and apart." Adopting the test enunciated in *Blockburger v. United States*, 284 U.S. 299 (1932), the court held that multiple crimes are distinct and separate offenses when one crime has elements in addition to and not included within the other crime. See Note, *Waiver of Double Jeopardy Right, The Impact of Jeffers v. United States*, 14 WAKE FOREST L. REV. 842 (1978). Defendant in *Vert* robbed a store, forced the clerk into a hall, shot her in the hip and tied her hand to a shopping cart. Noting that the kidnapping was unnecessary to the robbery, the court rejected defendant's argument that the restraint was not separate and apart under *Fulcher*. 39 N.C. App. at 30, 249 S.E.2d at 479.

55. 294 N.C. at 523, 243 S.E.2d at 351.

actually followed by the commission of the other.⁵⁶ Therefore, the court found no constitutional barrier to convicting a defendant both of kidnapping and of another felony that the kidnapping facilitates, provided the restraint is an act independent of and apart from the other felony.⁵⁷ Under the court's construction of G.S. 14-39 in *Fulcher*, that restraint need not be substantial in time.⁵⁸ The court thus found no double jeopardy problems in the conviction of defendant on two counts of crimes against nature and on two counts of kidnapping.

In *State v. Williams*,⁵⁹ the court was asked to determine whether G.S. 14-39⁶⁰ defines a single offense of kidnapping, or as has been widely thought,⁶¹ two grades of the offense. The court construed the statute to create a single offense, defined in subsection (a). Subsection (b) then prescribes a sentence of not less than twenty-five years and not more than life for the offense of kidnapping, and sets forth mitigating factors that, if present, permit a lesser punishment.⁶² The court found that this construction permits a conviction for kidnapping, as well as for another felony that negates the presence of mitigating factors, without violating the double jeopardy clause.⁶³ The court also outlined sentencing procedures to be followed in applying this interpretation of G.S. 14-39.

Defendant in *Williams* abducted a man and woman as they were leaving work. After taking them to a deserted spot, he robbed them, shot the man and raped the woman. He was subsequently convicted of first degree rape, assault with a deadly weapon with intent to inflict serious bodily injury, two counts of armed robbery and two counts of kidnapping.⁶⁴ On appeal, defendant argued that the State had obtained the convictions for aggravated kidnapping, carrying the harsher

56. *Id.* at 523-24, 243 S.E.2d at 351-52 (suggesting, *e.g.*, a breaking and entering with intent to commit larceny, followed by commission of larceny).

57. *Id.* at 524, 243 S.E.2d at 352.

58. *Id.*

59. 295 N.C. 655, 249 S.E.2d 709 (1978).

60. N.C. GEN. STAT. § 14-39 (Cum. Supp. 1977).

61. See note 67 *infra*.

62. 295 N.C. at 664, 249 S.E.2d at 716.

63. *Id.* at 668, 249 S.E.2d at 718.

64. 295 N.C. at 657, 249 S.E.2d at 712. Defendant was sentenced to life imprisonment for the rape, one of the kidnappings and one of the armed robberies, to 40 years for the other armed robbery, and to 20 years for the felonious assault, all to be served consecutively. He also received a life sentence for the other kidnapping to be served concurrently with the first. The court rejected defendant's argument that this sentence, amounting to 300 years (see N.C. GEN. STAT. § 14.2 (Cum. Supp. 1977)), constituted cruel and unusual punishment in violation of the eighth and fourteenth Amendments. 295 N.C. at 679-80, 249 S.E.2d at 725.

sentence, by using the facts of the assault and rape, and that the court could not therefore properly enter judgment on the assault and rape charges without punishing him twice for one offense.⁶⁵ This contention was based on the premise that G.S. 14-39 creates two offenses of kidnapping—simple and aggravated—with the State required to prove, for a conviction of the latter, not only the restraint, confinement or removal for one of the purposes designated in G.S. 14-39(a), but also, as an element of the aggravated offense, that the victim was either assaulted, seriously injured or not released in a safe place, as provided in G.S. 14-39(b).⁶⁶

In rejecting this construction, the court recognized that "[s]upport for [it] abounds everywhere but in the language of the statute itself."⁶⁷

65. 295 N.C. at 659-60, 249 S.E.2d at 713. Defendant relied on the principle that when a criminal offense in its entirety is an essential element of another offense a defendant may not be punished for both, based on the constitutional prohibition against double jeopardy. U.S. CONST. amend. V, XIV; N.C. CONST. art. I, § 19. See, e.g., *State v. Williams*, 284 N.C. 67, 199 S.E.2d 409 (1973); *State v. Carroll*, 282 N.C. 326, 193 S.E.2d 85 (1972); *State v. Midyette*, 270 N.C. 229, 154 S.E.2d 66 (1967).

66. 295 N.C. at 663, 249 S.E.2d at 715. Defendant also raised two other double jeopardy arguments. One was that the charges of armed robbery, the felonious assault and the rape were essential elements of kidnapping as defined under § 14-39(a)(2). *Id.* at 659-60, 249 S.E.2d at 713. The court had previously rejected this argument in *State v. Dammons*, 293 N.C. 263, 237 S.E.2d 834 (1977), on grounds that such charges are alleged as the purpose for which a defendant confined or restrained a victim, and not as elements of the offense that the State need prove. 295 N.C. at 660, 249 S.E.2d at 713-14.

Defendant also contended, in an argument new to the court, that the State and the judge had made the assault and the rape elements of kidnapping by treating them as such in the indictment and jury instructions. *Id.* at 661, 249 S.E.2d at 714. The court rejected this contention stating that an "[a]llegation of a matter [that] is not an element of the crime and not necessary to be proved may be treated as surplusage even if the State and the trial judge mistakenly believe the matter to be an essential element." *Id.* at 663, 249 S.E.2d at 715. See also *State v. Stallings*, 267 N.C. 405, 148 S.E.2d 252 (1966). The court distinguished the present situation from that in *State v. Midyette*, 270 N.C. 229, 154 S.E.2d 66 (1967). In that case the court stated: "By the allegations it elects to make in an indictment, the State may make one offense an essential element of another, though it is not inherently so" *Id.* at 233, 154 S.E.2d at 70. The *Williams* court concluded that the *Midyette* language refers only to those situations in which the State elects to prosecute on a legal theory that necessarily includes another offense as an element of the offense being prosecuted, although some other theory may have been available. 295 N.C. at 663, 249 S.E.2d at 715.

67. 295 N.C. at 663, 249 S.E.2d at 715. This construction was adopted by a divided panel in *State v. Gunther*, 38 N.C. App. 279, 248 S.E.2d 97 (1978) (holding that State has burden of proof concerning those factors that would subject a defendant to increased punishment, and that after entering the greater sentence, court may not enter judgment on charge of assault with intent to commit rape that was the same sexual act that provided the basis for the more severe punishment; supreme court reversed, however, 296 N.C. 578, 251 S.E.2d 462 (1979)). See also S. CLARKE, M. CROWELL, J. DRENNAN & D. GILL, NORTH CAROLINA CRIMES ch. 8, at 9-11 (Institute of Government, University of North Carolina at Chapel Hill, 1977); D. GILL & M. CROWELL, ARREST WARRANT FORMS (Institute of Government, University of North Carolina at Chapel Hill, 1978). Although the court has itself used the term "aggravated kidnapping" in prior cases, see, e.g., *State v. Barrow*, 292 N.C. 227, 232 S.E.2d 693 (1977), in *Banks v. State*, 295 N.C. 399, 245 S.E.2d 743 (1978), the court stated without elaboration:

We note in passing that some of our opinions refer to the crime defined in G.S. 14-

Relying on the statutory language, the court determined that subsection (b), rather than creating elements of an aggravated offense, presumes a conviction under subsection (a) and merely prescribes the punishment on conviction.⁶⁸ Relying on the purpose of the legislature in enacting subsection (b) to maximize a kidnapper's incentive to return the victim unharmed by offering a reduction in sentence, the court determined that the provision (b) factors are sentence-mitigating in nature rather than sentence-enhancing.⁶⁹ The court concluded that when the same or similar evidence tends to show both the absence of these factors and the commission of another crime, as in *Williams*, punishing a defendant for the other crime while not reducing his punishment for the kidnapping does not violate double jeopardy.⁷⁰

The court, in outlining procedures to be followed under its construction of G.S. 14-39, noted that a jury need normally determine only whether a defendant committed the substantive offense as defined in subsection (a).⁷¹ The existence or nonexistence of the mitigating factors in subsection (b) is to be determined by the judge,⁷² either from the evidence adduced at trial, or at a post-trial hearing provided by G.S. 15A-1334,⁷³ or both.⁷⁴ The court, relying on the rationale of *Patterson*

39A as "aggravated kidnapping." This is a misnomer. The proper term for the crime there defined is "kidnapping." Subsection (b) of the statute states the punishment for kidnapping as well as a lesser punishment when certain mitigating circumstances appear.

Id. at 406-07, 245 S.E.2d at 749.

68. 295 N.C. at 664, 249 S.E.2d at 716. The court noted that other courts have interpreted similar statutes as creating a single offense. *Id.* at 665, 249 S.E.2d at 716-17; see, e.g., *Smith v. United States*, 360 U.S. 1 (1959); *Pyles v. Boles*, 148 W. Va. 465, 135 S.E.2d 692, cert. denied, 379 U.S. 864 (1964). But see *State v. Sewell*, 342 So. 2d 156 (La. 1977).

69. 295 N.C. at 667, 249 S.E.2d at 717-18. The court assumed that the legislature's intent was the same as that of the drafters of the Model Penal Code. See MODEL PENAL CODE § 212.1, Comment at 19 (Tent. Draft No. 10, 1960).

70. 295 N.C. at 668, 249 S.E.2d at 718.

71. *Id.* at 669, 249 S.E.2d at 719.

72. *Id.* Because the factors in § 13-49(b) are sentence-reducing only and do not constitute an element of the offense, the court concluded that a defendant is not entitled to a jury determination. *Id.* at 673, 249 S.E.2d at 721.

73. N.C. GEN. STAT. § 15A-1334(b) (1978) provides:

Proceeding at Hearing. The defendant at the hearing may present witnesses and arguments on facts relevant to the sentencing decision and may cross-examine the other party's witnesses. No person other than the defendant, his counsel, the prosecutor, and one making a presentence report may comment to the court on sentencing unless called as a witness by the defendant, the prosecutor, or the court. Formal rules of evidence do not apply at the hearing.

Noting that § 15A-1334(b) makes "formal rules of evidence" inapplicable at this hearing, the court left to a case by case resolution the extent to which the rules may be relaxed and yet stay within the confines of due process. *Williams* does require that the judge make findings of fact in the sentencing hearing. 295 N.C. at 670-71, 249 S.E.2d at 720.

74. As the court indicated, the present case illustrated one circumstance in which the sentencing hearing was not necessary. When the existence of mitigating factors is determined by the jury

v. New York,⁷⁵ placed on the defendant the burden of satisfying the court by the preponderance of the evidence that the victim was released in a safe place and neither sexually assaulted nor seriously injured.⁷⁶

The court's construction of G.S. 14-39 in *Fulcher* and *Williams* is a new step in the sporadic evolution of kidnapping law in North Carolina.⁷⁷ The practical effect of the decisions is to permit the imposition of substantial additional sanctions when commission of a felony is accompanied by an seemingly insignificant movement or detention of the victim.⁷⁸ For example, a defendant who in the course of a robbery takes a clerk into the hall and ties her hand to a cart,⁷⁹ may after *Fulcher* be convicted for kidnapping as well as for the robbery. After *Williams* such a defendant faces a sentence of twenty-five years to life for the kidnapping alone unless he can satisfy the trial judge of the existence of the mitigating factors set out in subsection (b) that require a sentence of less than twenty-five years.

This present state of kidnapping law creates a potential for grave prosecutorial abuse by permitting in such circumstances a choice of prosecution for kidnapping, for the offense that the kidnapping overlaps, or for both.⁸⁰ Although the court in *Fulcher* noted that equal protection is not necessarily violated when a defendant who commits the same acts as another is prosecuted for two crimes while the other is prosecuted for only one, or because sentences are made to run consecutively for one defendant while concurrently for another, the court did recognize that there are serious problems with G.S. 14-39 as presently construed.⁸¹ Rather than attempting to cure these problems through judicial interpretation, however, as other courts have done,⁸² the court

in the course of trying separate criminal charges that have been joined to the kidnapping case, there is no need for a judge to make separate findings. 295 N.C. at 679, 249 S.E.2d at 725.

75. 432 U.S. 197 (1977).

76. *Id.* at 674, 249 S.E.2d at 722. The State may in any case stipulate to the presence of all mitigating factors and thereby avoid determination of the issue. *Id.* at 670, 249 S.E.2d at 719.

77. See Note, *Kidnapping in North Carolina—A Statutory Definition for the Offense*, 12 WAKE FOREST L. REV. 434 (1976).

78. See generally Note, *A Rationale of the Law of Kidnapping*, 53 COLUM. L. REV. 540 (1953).

79. See note 54 *supra*.

80. A caloused [*sic*] concept of kidnapping creates the potential for abusive prosecutions since virtually every false imprisonment, assault, battery, rape, robbery, escape or jail delivery will involve some movement or intentional confinement. When kidnapping, by definition overruns other crimes for which the prescribed punishment is less severe, a prosecutor has the "naked and arbitrary power" to choose the crime for which he will prosecute.

State v. Dix, 282 N.C. 490, 501, 193 S.E.2d 897, 903-04 (1973).

81. 294 N.C. at 525-26, 243 S.E.2d at 353.

82. See, e.g., *State v. Buggs*, 219 Kan. 203, 547 P.2d 720 (1976) (noting that legislature had

chose to leave reform to the legislature.⁸³ The court did suggest that relief might be available for a defendant when, through prosecutorial abuse, his criminal charges arising out of the same incident are "arbitrarily stacked like pancakes," resulting in a disproportionate sentence that violates fundamental fairness. Furthermore, the court invited the legislature to restore substantial asportation as an essential element of kidnapping.⁸⁴ Such a change would at least restore a more reasonable definition of kidnapping—one that does not permit the imposition of punishment for kidnapping unless an asportation significantly increases the dangerousness or undesirability of a defendant's conduct.⁸⁵

C. Rape

The constitutionality of North Carolina's new short-form rape indictment statute⁸⁶ was affirmed by the North Carolina Supreme Court in *State v. Lowe*.⁸⁷ The statute permits an indictment for first-degree rape without an averment of two essential elements of the crime: that the offense was perpetrated with a deadly weapon or by the infliction of serious harm, and that the defendant's age was greater than sixteen.⁸⁸

purposely not used "substantial" language of Model Penal Code, court nevertheless held word "facilitate," as used in "facilitate the commission of any felony," to mean more than a technical taking or confining). See also *People v. Daniels*, 71 Cal. 2d 1119, 459 P.2d 225, 80 Cal. Rptr. 897 (1969); *People v. Levy*, 15 N.Y.2d 159, 204 N.E.2d 842, 256 N.Y.S.2d 793, cert. denied, 381 U.S. 938 (1965).

83. 294 N.C. at 527, 243 S.E.2d at 354; accord, *State v. Morris*, 281 Minn. 119, 160 N.W.2d 715 (1968). See also Comment, *Keeping Kidnapping in Its Place: When Does the Kentucky Exemption Apply?*, 66 Ky. L.J. 448 (1977); Note, *supra* note 77.

84. 294 N.C. at 526-27, 243 S.E.2d at 353.

85. See Note, *supra* note 78, at 556 n.99 (suggesting that if penalties for primary offenses are thought to be inadequate then proper solution is to raise them rather than to superimpose an additional penalty under guise of kidnapping). See also MODEL PENAL CODE § 212.1, Comment at 19 (Tent. Draft No. 10, 1960).

86. N.C. GEN. STAT. § 15-144.1(a) (1978) provides in pertinent part:

In indictments for rape . . . in the body of the indictment, after naming the person accused, the date of the offense, the county in which the offense of rape was allegedly committed, and the averment "with force and arms," as is now usual, it is sufficient in describing rape to allege that the accused person unlawfully, willfully, and feloniously did ravish and carnally know the victim, naming her, by force and against her will and concluding as is now required by law.

The term "short-form" indictment means an indictment that does not require an allegation of all essential elements of the crime.

87. 295 N.C. 596, 247 S.E.2d 878 (1978).

88. The elements of first degree rape, the victim being 12 years of age or older, are: (1) carnal knowledge of a female person, (2) by force, (3) against the will of the victim, (4) by a defendant over the age of 16, (5) who procures the submission or overcomes the resistance of the victim by the use of a deadly weapon or the infliction of serious bodily harm. *State v. Perry*, 291 N.C. 586, 231 S.E.2d 262 (1977); N.C. GEN. STAT. § 14-21 (Cum. Supp. 1977). In *Perry*, the North Carolina Supreme Court held the old form of indictment for rape insufficient to support a conviction for first degree rape because it failed to require an allegation that the defendant was over 16 years of

Defendant in *Lowe* challenged the statute on the ground that an indictment prepared in accordance with the statute does not provide the accused with notice of the offense sufficient to prepare his defense and protect him from double jeopardy.⁸⁹ In sustaining the statute, the court held that precisely those interests defendant asserted were not protected by the statute—sufficient notice of the crime to permit preparation of a defense and avoidance of subsequent prosecution for the same crime—are those that an indictment must protect to pass constitutional muster.⁹⁰ In finding these requirements met by the rape indictment statute, the court relied on decisions upholding the validity of the state's short-form homicide indictment.⁹¹ This case reaffirms the power of the legislature to enact an indictment statute relieving the State from the common law requirement that an indictment allege every element of the offense charged.

Applying this constitutional standard, the court noted that an indictment prepared according to the new statute identifies the accused, the date, and location of the offense and uses words of "precise legal import" to specify the charged offense.⁹² The court further pointed out that a defendant may always ask for a bill of particulars to obtain information in addition to that contained in the indictment in order to clarify the charge and prevent surprise at trial.⁹³ Because the function of a motion for a bill of particulars is to allow the defense to obtain information regarding the specific occurrences to be investigated at trial,⁹⁴ liberal grants of such motions will minimize any adverse effects the *Lowe* decision may have on the preparation of a defense. With the expansion of criminal discovery procedures,⁹⁵ *Lowe* emphasizes that

age and that he used deadly force to commit the crime. The new rape indictment statute was a reaction to this decision and allows the omission of the very elements found necessary in *Perry*.

89. 295 N.C. at 599, 247 S.E.2d at 881.

90. *Id.* at 603, 247 S.E.2d at 883. "In all criminal prosecutions, every person charged with crime has the right to be informed of the accusation . . ." N.C. CONST. art. I, § 23. In addition, the *Lowe* court ruled an indictment must also enable the court to know what judgment to pronounce in case of conviction. 295 N.C. at 603, 247 S.E.2d at 883.

91. 295 N.C. at 600-03, 247 S.E.2d at 881-83; see *State v. Duncan*, 282 N.C. 412, 193 S.E.2d 65 (1972); *State v. Kirksey*, 227 N.C. 445, 42 S.E.2d 613 (1947); *State v. Moore*, 104 N.C. 743, 10 S.E. 183 (1889). The short-form homicide indictment, N.C. GEN. STAT. § 15-144 (1978), allows an indictment for first degree murder without an averment of the essential elements of premeditation and deliberation.

92. 295 N.C. at 604, 247 S.E.2d at 883.

93. *Id.*; see N.C. GEN. STAT. § 15A-925 (1978) (bill of particulars).

94. *State v. Swift*, 290 N.C. 838, 226 S.E.2d 652 (1976); *State v. Spence*, 271 N.C. 23, 155 S.E.2d 802 (1967), *vacated on other grounds per curiam*, 392 U.S. 649 (1968); *State v. Overman*, 269 N.C. 453, 153 S.E.2d 44 (1967); *State v. Seaboard Air Line Ry.*, 149 N.C. 508, 62 S.E. 1088 (1908).

95. See N.C. GEN. STAT. §§ 15A-901 to -919 (1978) (criminal discovery procedure).

the purpose of the indictment is only to give notice to the defendant of the alleged criminal offense.

In *State v. Bailey*,⁹⁶ the North Carolina Court of Appeals was presented with the question whether the "force" necessary for the crime of rape is that which reasonably induces fear of serious bodily harm.⁹⁷ In *Bailey*, defendant was indicted and convicted of second-degree rape.⁹⁸ On appeal from his conviction, defendant argued that the trial judge had erred in failing to instruct the jury that the force necessary to constitute an element of rape must be force that "reasonably induces fear of serious bodily harm."⁹⁹ The court of appeals affirmed the conviction, rejecting the contention that the North Carolina Supreme Court had adopted this objective test.¹⁰⁰

The decision in *Bailey* affirms the rule in North Carolina that there is no objective test with respect to the force involved in a rape. Such a rule comports with the view in the majority of jurisdictions.¹⁰¹ North Carolina cases indicate "force" is a broadly defined concept and the requisite amount to support a conviction for rape need only be that which is sufficient to overcome the will of the victim.¹⁰² The continuation of this subjective standard by which force is to be measured is proper because a defendant should not escape punishment for rape by reason of his victim's unreasonable fears of violence.¹⁰³ To hold otherwise would be to punish the victim for her nonconformity to the standard set by the "reasonable" victim. Moreover, the likelihood of unfair

96. 36 N.C. App. 728, 245 S.E.2d 97 (1978).

97. *Id.* at 732, 245 S.E.2d at 100.

98. *Id.* at 728-29, 245 S.E.2d at 98.

99. *Id.* at 732, 245 S.E.2d at 100. The basis for defendant's argument was one sentence in *State v. Burns*, 287 N.C. 102, 214 S.E.2d 56, *cert. denied*, 423 U.S. 933 (1975). The contested sentence read, "A threat of serious bodily harm which reasonably induces fear thereof constitutes the requisite force and negates consent." *Id.* at 116, 214 S.E.2d at 65. The authorities cited by the *Burns* court in support fail to mention the word reasonable with respect to the force element. See *State v. Henderson*, 285 N.C. 1, 203 S.E.2d 10 (1974), *death penalty vacated*, 428 U.S. 902 (1976); *State v. Bryant*, 280 N.C. 551, 187 S.E.2d 111, *cert. denied*, 409 U.S. 995 (1972).

100. 36 N.C. App. at 733, 245 S.E.2d at 100.

101. See 65 AM. JUR. 2d *Rape* § 4 (1972).

102. See *State v. Armstrong*, 287 N.C. 60, 212 S.E.2d 894 (1975) (fear, fright or coercion may take the place of physical force); *State v. Henderson*, 285 N.C. 1, 203 S.E.2d 10 (1974), *death penalty vacated*, 428 U.S. 902 (1976); *State v. Primes*, 275 N.C. 61, 165 S.E.2d 225 (1969); *State v. Thompson*, 227 N.C. 19, 40 S.E.2d 620 (1946); *State v. Johnson*, 226 N.C. 671, 40 S.E.2d 113 (1946); 11 STRONG'S NORTH CAROLINA INDEX 3d *Rape and Allied Offenses* § 1 (1978) ("The 'force' necessary to constitute the offense need not be actual physical force; constructive force is sufficient, and the female's submission under fear or distress takes the place of actual physical force.").

103. This was the view of the draftsmen of the Model Penal Code provision for rape. MODEL PENAL CODE § 207.4, Comments (Tent. Draft No. 4, 1955).

convictions is not increased by the use of a subjective standard because in most rape trials the jurors will inject some degree of objectivity into their determination of the force element.¹⁰⁴

D. Public Intoxication¹⁰⁵

In response to the growing concern over the public drunkenness problem and acceptance that alcoholism is the real cause of the large number of drunkenness arrests¹⁰⁶ a proposal of the attorney general intended to deal with public drunks was enacted into law.¹⁰⁷ A new offense of "intoxicated and disruptive in public" is created by the statute,¹⁰⁸ and provision is made for giving assistance to persons intoxicated in public without the necessity of first arresting them.¹⁰⁹

The new legislation made several fundamental changes in the public drunkenness law.¹¹⁰ The new offense of intoxicated and disruptive

104. If the victim's submission seems highly contradictory to that of the ordinary person under the circumstances, the jury will most likely disbelieve the victim's contention that force was involved. See Note, *Recent Statutory Developments in the Definition of Forcible Rape*, 61 VA. L. REV. 1500 (1975).

105. In 1978 the North Carolina General Assembly enacted an amendment to N.C. GEN. STAT. § 20-179(a), effective March 1, 1979, to increase the punishment for driving under the influence of intoxicating liquor, narcotic drugs, or other impairing drugs. Law of June 16, 1978, ch. 1222, 1977 N.C. Sess. Laws, 2d Sess. 1978, at 171. Under this amendment, a first offense remains punishable in the discretion of the court by a fine of not less than \$100 nor more than \$500, by imprisonment for not more than six months, or by both fine and imprisonment. For second and subsequent convictions, however, the judge is required to impose a mandatory sentence of three days, which is not subject to suspension or parole, and to impose a fine. A second conviction is punishable by imprisonment for not less than three days nor more than one year, and a fine not less than \$200 nor more than \$500; a third or subsequent conviction is punishable by imprisonment for not less than three days nor more than two years and a fine of not less than \$500. The jail sentence may, however, be suspended for a second offender if the defendant successfully completes an alcohol or drug rehabilitation program approved by the Department of Human Resources.

The effect of this amendment will not become apparent for some time. The statute contains certain provisions that mitigate its potential severity: no convictions occurring prior to July 1, 1978, are to be considered prior offenses, and to be a prior conviction, the offense must occur within three years of the current offense.

106. Drunkenness arrests in North Carolina have averaged approximately 50,000 per year. For a discussion of the background against which this new legislation was enacted, see Crowell, *The New Law of Public Drunkenness*, AD. J. MEMORANDA, Sept. 1978, at 1.

107. N.C. GEN. STAT. §§ 14-443 to -447, 15A-534(c), 122-58.22, .23, -65.10 to .13 (Interim Supp. 1978).

108. *Id.* § 14-444. Section 14-443(2) defines intoxicated as "the condition of a person whose mental or physical functioning is presently substantially impaired as a result of the use of alcohol." *Id.* § 14-443(2). Section 14-443(3) defines public place as "a place which is open to the public, whether it is publicly or privately owned." *Id.* § 14-443(3).

109. *Id.* § 122-65.11 (Interim Supp. 1978).

110. The General Assembly repealed several drunkenness statutes. The former statutes of public drunkenness, Law of Feb. 13, 1897, ch. 57, 1897 N.C. Pub. Laws 109 (formerly codified as amended at N.C. GEN. STAT. § 14-335); drunk and disorderly, Law of March 9, 1921, ch. 211,

requires the additional element of disruptiveness¹¹¹ for the drunk to violate the law; no longer may a person be prosecuted solely for being intoxicated in a public place.¹¹² The new legislation further provides that alcoholism¹¹³ is to be considered a defense to the charge of drunk and disruptive.¹¹⁴ Moreover, G.S. 14-145(b) requires that the trial judge consider alcoholism as a defense to the charge even if the defendant does not raise it, and empowers the judge to request additional information in making the determination whether the defendant is suffering from alcoholism.¹¹⁵

Another provision changing prior law allows a law enforcement officer, after making the determination that a person to be arrested would benefit from the care of a shelter as provided for in G.S. 122-65.11,¹¹⁶ to transport and release the person to the facility after issuing him a citation for the offense of drunk and disruptive.¹¹⁷

The offense of drunk and disruptive is a misdemeanor punishable by a fine of not more than fifty dollars, or imprisonment of not more than thirty days; a magistrate is not empowered to accept a plea of guilty and enter judgment for this offense.¹¹⁸ If the defendant is acquitted on the defense of alcoholism, the court must then determine if the defendant is an alcoholic in need of care as defined by G.S. 122-58.22¹¹⁹ or G.S. 122-58.23.¹²⁰ This determination is to be made at a

1921 N.C. Pub. Laws 503 (formerly codified as amended at N.C. GEN. STAT. § 14-334); detention of public drunks, Law of May 23, 1973, ch. 696, 1973 N.C. Sess. Laws 1038 (formerly codified as amended at N.C. GEN. STAT. § 14-335.1); and the statutory provisions dealing with chronic alcoholics, Law of July 6, 1967, ch. 1256, § 2, 1967 N.C. Sess. Laws 1894 (formerly codified as amended at N.C. GEN. STAT. §§ 122-65.8 to .9) were repealed by the new Act.

111. Disruptive conduct includes interfering with traffic, blocking sidewalks, grabbing, pushing, fighting, cursing, shouting, or begging for money. N.C. GEN. STAT. § 14-444(a) (Interim Supp. 1978).

112. *Id.* § 14-447(a). A person who is intoxicated in a public place and is not disruptive may be assisted as provided by *id.* § 122-65.11. See text accompanying notes 123-33 *infra*.

113. Alcoholism is defined as "the state of a person . . . who habitually lacks self control as to the use of intoxicating liquor, or uses intoxicating liquor to the extent that his health is substantially impaired or endangered or his social or economic function is substantially disrupted." N.C. GEN. STAT. § 14-443(1) (Interim Supp. 1978).

114. *Id.* § 14-445(a).

115. *Id.* § 14-445(b). Application of this provision may raise constitutional questions. If the defendant or his attorney affirmatively refuses the defense and the judge still insists upon it, due process may be abridged or the sixth amendment right to counsel denied. Crowell, *supra* note 106, at 4.

116. N.C. GEN. STAT. § 122-65.11 (Interim Supp. 1978); see text accompanying notes 123-33 *infra*.

117. N.C. GEN. STAT. § 14-447(b) (Interim Supp. 1978).

118. *Id.* § 14-444(b).

119. *Id.* § 122-58.22; see text accompanying note 137 *infra*.

120. N.C. GEN. STAT. § 122-58.23 (Interim Supp. 1978); see text accompanying note 137 *infra*.

district court hearing, which may be held at the time defendant is found not guilty by reason of alcoholism or within a fifteen day period after such finding is made.¹²¹

The portion of this statute that provides for assistance to an intoxicated person without the necessity of first arresting him is the most significant reform made in existing law. The type of assistance that will be provided by law enforcement officers under G.S. 122-65.11 depends upon the condition of the intoxicated person.¹²² If the person is *only* intoxicated, he may be taken home¹²³ or to the home of anyone willing to accept him;¹²⁴ if he is in need of medical care, he will be taken to an appropriate facility or doctor's office;¹²⁵ if he is in need of food and shelter, he will be taken to a shelter approved by the Department of Human Resources.¹²⁶

The shelter contemplated by this provision is a "social setting" detoxification center, which would provide the alcoholic with food, shelter, and medical care by referral.¹²⁷ Significantly absent from the Act is any provision for funding these facilities. Although many localities have out-patient programs, or in-patient medical detoxification programs in hospitals, there are only six social setting detoxification centers in the state;¹²⁸ this is obviously not sufficient to meet the demands of this statute's program. The cost of providing the additional beds necessary to successful implementation of this Act is estimated at over two billion dollars.¹²⁹ Obviously, therefore, in many instances there will not be any facility to which to send the people that are to be assisted under the law. In recognition of this possibility, G.S. 122-65.13 does provide that if a person is found intoxicated in public and is in need of food or shelter, but not medical care, the officer may take the person to the city or county jail if there is no place else to take him.¹³⁰

121. N.C. GEN. STAT. § 14-446 (Interim Supp. 1978).

122. In providing the assistance authorized by this statute, the officer is permitted to use reasonable force to protect himself, the intoxicated person, or others; no officer may be held civilly or criminally liable for actions taken as reasonable measures under the authority of § 122-65.11. *Id.* § 122-65.11(b). *Id.* § 122-65.12 authorizes the city or county to hire additional officers to assist intoxicated persons. Employees hired under this provision are to be trained in first aid and empowered with the authority and duty of a law enforcement officer acting under *id.* § 122-65.11.

123. *Id.* § 122-65.11(a)(1).

124. *Id.* § 122-65.11(a)(2).

125. *Id.* § 122-65.11(a)(4).

126. *Id.* § 122-65.11(a)(3).

127. *See* Crowell, *supra* note 106, at 5.

128. *See id.*

129. *See id.* at 5-6.

130. N.C. GEN. STAT. § 122-65.13 (Interim Supp. 1978). It is likely that jail will be used regu-

If brought to jail, the person may be detained only until he becomes sober or a maximum of twenty-four hours, and he may be released at any time to a relative or any other person willing to accept him.¹³¹

Once an intoxicated person has been taken to either a medical or a detoxification center, he may be detained until he becomes sober, or for a maximum of twenty-four hours; he can be held longer only if he chooses to remain in the facility voluntarily or if a court order is obtained to detain him.¹³² To obtain a court order, a finding that it is probable the person is an alcoholic in need of care must be made by a clerk or magistrate. If this finding is not made, the person must be released; if probable cause is found, the person may be ordered detained for up to ninety-six hours to arrange an appearance before a district court judge for a full hearing to determine if the person is an alcoholic in need of care.¹³³ A similar hearing before a district court judge may also be held if by reason of alcoholism the person is found not guilty of a charge under G.S. 14-446.¹³⁴

The hearing provided for under G.S. 14-446 or G.S. 122-65.11(d) is a full hearing intended to determine if the alcoholic should be committed for either short-term treatment or long-term residential care. At such a hearing, the alleged alcoholic must be represented by counsel if he so desires and is entitled to confront and cross-examine witnesses against him.¹³⁵ If available and if the district judge believes it would be helpful, an alcoholism counselor may be appointed to make a prehearing review of the alcoholic and his condition that will be considered by the judge in making his determination.¹³⁶ If the person is found to be an alcoholic in need of care¹³⁷ and is ordered to participate in a treatment program,¹³⁸ he has the right to appeal and the judge is required to

larly in rural areas where it would not be economically feasible to build a detoxification center; in all other areas, use of a jail is meant only to be a last resort. Crowell, *supra* note 106, at 6.

131. N.C. GEN. STAT. § 122-65.13 (Interim Supp. 1978).

132. *Id.* § 122-65.11(c).

133. *Id.* § 122-65.11(d).

134. *Id.* §§ 14-446, 122-58.22(b).

135. *Id.* § 122-58.22(d). If the alleged alcoholic is an indigent and does not waive counsel, counsel must be appointed. *Id.*

136. *Id.* § 122-58.22(c).

137. In the context of short-term treatment under *id.* § 122-58.22, a person is an alcoholic if "he habitually lacks self-control as to the use of intoxicating liquor, or uses intoxicating liquor to the extent that his health is substantially impaired or endangered or his social or economic function is substantially disrupted." An alcoholic is in need of care if "his alcoholism is presently causing him to lose control over his own actions to the extent that he regularly has to depend on others to provide food, clothing, shelter, medical or other essential care for him." This definition is applicable to both short-term treatment and long-term residential care. *Id.* § 122-58.23(a)(1).

138. See *id.* § 122-58.22(e)(2).

record facts that support his findings to facilitate the appeal.¹³⁹

Once a person is found to be an alcoholic in need of care, the judge may order short-term commitment under G.S. 122-58.22(e).¹⁴⁰ Under this provision, the judge has the option to suggest that the alcoholic participate voluntarily in an alcohol treatment program or to order mandatory participation for up to thirty days. Under G.S. 122-58.23 the judge may order long-term residential care if certain elements in addition to those required for short-term commitment have been demonstrated at the hearing.¹⁴¹ For long term residential care to be statutorily permitted, clear and convincing evidence must show that the alcoholic is a person in need of care as defined by G.S. 122-56.22,¹⁴² that he has been given recent opportunities to participate in alcoholism treatment programs, and that he has wilfully refused to participate or cooperate in such programs or has failed to show significant progress toward overcoming his alcoholism. If these factors have been sufficiently demonstrated, the judge may order the alcoholic committed to a residential facility for up to 180 days.¹⁴³ G.S. 122-58.23(c) allows for release at any time prior to the end of the court-ordered period of commitment if the director of the facility determines that the person is no longer in need of the care of that facility.¹⁴⁴ If at the end of the period of commitment the director feels that the alcoholic needs further care, he may under the procedure of G.S. 122-58.11¹⁴⁵ request a hearing for an additional commitment.¹⁴⁶

The final provision of the Act amends the bail statute¹⁴⁷ by adding that a factor to be considered in determining the form of pretrial release is "whether the defendant is intoxicated to such a degree that he would be endangered by being released without supervision."¹⁴⁸ This provision will empower the magistrate to set a very high bail when the defendant is too intoxicated to be responsible for himself or to drive

139. *Id.* § 122-58.22(d). This provision applies only when the judge elects mandatory participation for the alcoholic as provided by § 122-58.22(e)(2). See Crowell, *supra* note 106, at 10.

140. N.C. GEN. STAT. § 122-58.22(e) (Interim Supp. 1978).

141. *Id.* § 122-58.23. The requirements for the hearing on long-term commitment are the same as for short-term commitment under § 122-58.22(c) & (d), except for the added requirement that at least 48 hours notice of the hearing must be given to the alleged alcoholic and his counsel. *Id.* § 122-58.23(b).

142. See note 137 *supra*.

143. N.C. GEN. STAT. § 122-58.23(a) (Interim Supp. 1978).

144. *Id.* § 122-58.23(c).

145. *Id.* § 122-58.11 (Cum. Supp. 1977).

146. *Id.* § 122-58.23(d) (Interim Supp. 1978).

147. *Id.* §§ 15A-531 to -547 (1978 & Interim Supp. 1978).

148. *Id.* § 15A-534(c) (Interim Supp. 1978).

safely, and then lower the bail a few hours later when he becomes sober.¹⁴⁹

This legislation is clearly intended to be a comprehensive plan for the rehabilitation of public drunks. The success of the plan is dependent upon the effectiveness of the detoxification centers that are to deal with the alcoholics assisted under this Act. At the present time, there are not enough beds to treat every person arrested or referred under the new statute. If the statute is to be effective in reducing the problem of alcoholism, it will be necessary for more facilities to be built. Until more detoxification facilities can be built, the success of the legislation depends upon the district judges working closely with local officials to ensure that no one directed to a facility is turned away.¹⁵⁰

E. Plea Bargaining

Because of the great importance of plea bargaining in the administration of criminal justice in this state,¹⁵¹ and the paucity of case law development on the subject, the North Carolina Court of Appeals' decision in *Northeast Motor Co. v. North Carolina State Board of Alcoholic Control*, dealing with the scope of the State's obligation to comply with plea bargaining agreements, is particularly significant.¹⁵² Petitioner in *Northeast Motor Co.* was charged by the Board of Alcoholic Control with a violation of the state alcoholic beverage control laws.¹⁵³ In connection with the alleged ABC violations, an employee of petitioner was charged with the criminal violation of selling beer to a minor. Pursuant to a plea bargain agreement between the employee and the assistant district attorney, the employee entered a plea of nolo contendere and the State agreed "not to take any further action by way of hearing before any court, board, or agency arising out of this transaction against [the employee or petitioner]."¹⁵⁴ Subsequently, the Board of Alcoholic Control suspended petitioner's ABC permit for fifteen days. Petitioner appealed the decision on the ground the Board of Alcoholic Control was estopped from instituting the proceeding in which petitioner's license was revoked by reason of the plea bargain agree-

149. See Crowell, *supra* note 106, at 11-12.

150. *Id.* at 12.

151. See *State v. Slade*, 291 N.C. 275, 229 S.E.2d 921 (1976) ("We are aware that 'plea bargaining' has emerged as a major aspect in the administration of criminal justice.").

152. 35 N.C. App. 536, 241 S.E.2d 727 (1978).

153. *Id.* at 536, 241 S.E.2d at 728. The charge was knowingly selling malt beverages to a minor upon licensed premises.

154. *Id.* at 537, 241 S.E.2d at 728.

ment in the criminal action.¹⁵⁵ Relief was denied by the trial court and the court of appeals affirmed on the ground that neither petitioner nor the Board of Alcoholic Control was a party to the plea bargain agreement in the criminal proceeding.¹⁵⁶

In 1973 the North Carolina General Assembly passed article 58 of the Criminal Procedure Act, which endorsed the plea bargaining process as a means of expediting the criminal process.¹⁵⁷ The decision in *Northeast Motor Co.* recognizes the deficiency of case law development in this area¹⁵⁸ and attempts to define the scope of liability for breach of a plea bargain agreement. The court adopted the rule that a defendant may be granted relief for the breach of agreements induced by both authorized and unauthorized promises by a prosecutor.¹⁵⁹ This scope of liability is in conformity with that adopted by the federal courts¹⁶⁰ and complements the intent of the draftsmen of article 58 to bring the plea bargaining process out of its shroud of secrecy.¹⁶¹ Although the court's definition of the scope of potential liability was unnecessary to decide the case,¹⁶² it informs the criminal defendant of his rights with respect to plea bargain agreements.¹⁶³ Because the result in *Northeast*

155. *Id.*

156. *Id.* at 539, 241 S.E.2d at 729. The court held that on this ground petitioner did not have standing to enforce the agreement. The court explicitly reserved judgment on the question whether the Board of Alcoholic Control, a state agency, could bind itself by a plea bargain agreement in a criminal proceeding in which it was not a party. *Id.*

157. N.C. GEN. STAT. §§ 15A-1021 to -1027 (1978). The purpose of the plea bargaining statute was to set forth certain procedures to be followed in the plea bargaining process, to allow the defendant to tell the court the truth about plea bargaining arrangements and to eliminate the amount of collateral attacks on convictions based on guilty pleas. The procedure was modeled after the ALI MODEL CODE OF PRE-ARRAIGNMENT PROCEDURES art. 350 (Tent. Draft No. 5, 1972).

158. There have been very few cases in North Carolina in which the court addressed plea bargaining issues. In *State v. Williams*, 291 N.C. 442, 230 S.E.2d 515 (1976), the supreme court ruled that a defendant is entitled to a continuance as a matter of right under N.C. GEN. STAT. § 15A-1024 (1978) when the trial judge at the time for sentencing determines that a different sentence from that provided in the plea agreement must be imposed. See also *State v. Lewis*, 32 N.C. App. 298, 231 S.E.2d 693 (1977) (interpreting § 15A-1025).

159. 35 N.C. App. at 538-39, 241 S.E.2d at 729-30.

160. In reaching its decision the court relied on *Santobello v. New York*, 404 U.S. 257, 262 (1971) ("where a plea rests in any significant degree on a promise or agreement of the prosecutor, so that it can be said to be part of the inducement or consideration, such promises must be fulfilled"); *Palermo v. Warden*, 545 F.2d 286, 296 (2d Cir. 1976) ("where a defendant pleads guilty because he reasonably relies on promises by the prosecutor which are in fact unfulfillable, he has a right to have those promises fulfilled"); *United States v. Hammerman*, 528 F.2d 326, 331 (4th Cir. 1975) (assurances not within power of prosecutor to make on which defendant relies to plead guilty constitute grounds for relief). See also *Correale v. United States*, 479 F.2d 994 (1st Cir. 1973); *Walter v. Harris*, 460 F.2d 988 (4th Cir. 1972), *cert. denied*, 409 U.S. 1129 (1973).

161. See note 157 *supra*.

162. See note 156 *supra*.

163. It also puts the State on notice to monitor carefully the promises it makes.

Motor Co. was one of nonliability, however, it remains for future decisions to outline the remedies available for breach of such agreements.¹⁶⁴

F. Narcotics

In *State v. Forney*,¹⁶⁵ the North Carolina Court of Appeals confronted the issue of the extent of dominion and control¹⁶⁶ sufficient to support a charge of sale and delivery of heroin and possession of heroin with the intent to sell and deliver.¹⁶⁷ Two State Bureau of Investigation (SBI) agents told defendant that they were interested in purchasing heroin. Defendant arranged a meeting for this purpose, and brought along another person, who negotiated the sale and handed the agent the drugs for the agreed upon price. Defendant contended that there was, therefore, no evidence tending to show that he had possession of the heroin.¹⁶⁸

The issue whether dominion and control predicated upon a working relationship of this nature is sufficient to constitute possession had not yet been decided in the North Carolina courts.¹⁶⁹ There is precedent that "an accused has possession . . . within the meaning of the law when he has both the power and intent to control its disposition or use. The requisite power to control may reside in the accused acting

164. In cases in which the prosecutor promised there would be no further criminal prosecution, something that is in his power to control, specific enforcement of the bargain has been ordered. See *Correale v. United States*, 479 F.2d 944 (1st Cir. 1973); *United States v. Carter*, 454 F.2d 426 (4th Cir. 1972), *cert. denied*, 417 U.S. 933 (1974); *United States v. Paina*, 294 F. Supp. 742 (D.D.C. 1969). The other alternative, particularly for an unfulfillable promise, would be to allow withdrawal of a guilty plea. See *United States v. Hammerman*, 528 F.2d 326 (4th Cir. 1975).

165. 38 N.C. App. 703, 248 S.E.2d 747 (1978).

166. Dominion and control over a narcotic or dangerous drug is an essential element of the criminal offense of possession. The control incident to possession may be actual or constructive, but it has been held that the narcotic or dangerous drug must be in the immediate and exclusive control of the accused. 28 C.J.S. *Drugs and Narcotics Supp.* § 157 (1974).

167. 38 N.C. App. 706-07, 248 S.E.2d at 749-50. N.C. GEN. STAT. § 90-95(a) (1975) provides:

[I]t is unlawful for any person: (1) To manufacture, sell or deliver or possess with intent to manufacture, sell or deliver, a controlled substance; (2) To create, sell or deliver, or possess with intent to sell or deliver, a counterfeit controlled substance; (3) To possess a controlled substance.

168. 38 N.C. App. at 704-06, 248 S.E.2d at 748-49.

169. In jurisdictions that have considered the issue, the criminality of directing to or recommending a source of supply begins to form as one moves along a continuum from a single, casual naming of another possible source to accompanying another to a meeting with the seller during which the sale takes place. Whether defendant accompanies the buyer to the meeting seems to determine whether defendant's actions will likely be found criminal. See *Annot.*, 42 A.L.R.3d 1072 (1972).

alone or in combination with others."¹⁷⁰ The court could have applied this definition of constructive possession and based its decision on existing interpretations well supported in the case law of a number of jurisdictions including North Carolina.¹⁷¹ Instead the court chose to base its decision upon cases decided under former section 2(c) of the Narcotic Drugs Import and Export Act.¹⁷² Possession under this statute had been defined to include any working relationship or association with one having physical custody of drugs that enabled delivery to a customer without difficulty.¹⁷³

Applying the reasoning developed in these cases, the *Forney* court held defendant to be in possession of the heroin. Defendant produced the unidentified man on short notice at a place of defendant's choosing; the man arrived with the amount of heroin desired by the agents, apparently with prior knowledge that the SBI agents were the individuals who wished to make the purchase; and the man entered into the price negotiations with people otherwise unknown to him. These facts indicate a close working relationship between defendant and the unidentified man. Based upon this relationship, defendant was found to be in possession of the heroin by exercising dominion and control over the man who physically possessed the drugs.¹⁷⁴

In *State v. Bethea*,¹⁷⁵ section 1175 of the federal Drug Abuse Office and Treatment Act¹⁷⁶ was construed by the North Carolina Court of Appeals for the first time. This statute was enacted to protect the confidentiality of patient records maintained in connection with any federally funded drug abuse prevention program.¹⁷⁷ In this case, defendant

170. *State v. Allen*, 279 N.C. 406, 411, 183 S.E.2d 680, 684 (1971) (quoting *State v. Fuqua*, 234 N.C. 168, 170, 66 S.E.2d 667, 668 (1951)).

171. *See State v. Harvey*, 281 N.C. 1, 187 S.E.2d 706 (1972); *State v. Spencer*, 281 N.C. 121, 187 S.E.2d 779 (1972). *See generally* 28 C.J.S. *Drugs and Narcotics Supp.* § 158 (1974).

172. Act of July 18, 1956, ch. 629, § 105, 70 Stat. 567 (formerly codified at 21 U.S.C. § 174) (repealed 1970). The statute read in pertinent part: "[W]henever . . . the defendant is shown to have or to have had possession of the narcotic drugs, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury."

173. *See, e.g., United States v. Baratta*, 397 F.2d 215, 224 (2d Cir.), *cert. denied*, 393 U.S. 939 (1968) (evidence of "working relationship" between defendant and actual possessors of narcotics constitutes dominion and control sufficient to constitute possession); *Cellino v. United States*, 276 F.2d 941 (9th Cir. 1960) (negotiation of sale and receipt of purchase price sufficient dominion and control to constitute possession), *cited with approval in State v. Forney*, 38 N.C. App. 703, 706, 248 S.E.2d 747, 749-50.

174. 38 N.C. App. at 706, 248 S.E.2d at 749-50.

175. 35 N.C. App. 512, 241 S.E.2d 869 (1978).

176. 21 U.S.C. § 1175 (1976).

177. Section 1175 provides for confidentiality of patient records concerning the identity, diagnosis, prognosis, or treatment of any patient maintained in connection with any drug abuse pre-

was charged with possession with intent to sell and deliver, and sale and delivery of a controlled substance, methadone.¹⁷⁸ Defendant argued that because the sale was initiated by an SBI agent using a third-party informant who was an out-patient with defendant at the Durham Drug Rehabilitation Center, the evidence obtained from observation of the sale should be excluded because it was acquired in clear violation of the regulations promulgated under section 1175.¹⁷⁹ The relevant regulation flatly prohibits the enrollment of informants in drug abuse treatment programs.¹⁸⁰

In rejecting defendant's contention the court relied upon *Armenta v. Superior Court*,¹⁸¹ a California case that also dealt with an informant under this regulation. After a thorough consideration of the legislative history of this statute, the California court concluded that only confidential records obtained in violation of section 1175 were intended to be subject to exclusion.¹⁸² Relying on this interpretation by the California court, the North Carolina Court of Appeals concluded that defendant's motion to suppress was properly denied even though the letter of the federal regulation was violated, because the evidence obtained by use of the informant did not include the confidential records of defendant.¹⁸³

In reaching this conclusion, North Carolina is in accord with the interpretation of section 1175 and the regulations promulgated under it reached by the few jurisdictions that have considered the issue.¹⁸⁴ The

vention function conducted, regulated or assisted by the government. Except as authorized by a court order granted under this section, no patient record may be used to initiate or substantiate any criminal charges against a patient or to conduct any investigation of a patient. *Id.*

178. 35 N.C. App. at 513, 241 S.E.2d at 870.

179. *Id.* at 514, 241 S.E.2d at 870-71. The Secretary of Health, Education and Welfare, and the heads of other affected agencies, are given authority, under 21 U.S.C. § 1175(g) (1976), to prescribe regulations to carry out the purposes of § 1175.

180. 42 C.F.R. § 2.19(b)(1) (1977). Section 2.19(a)(2) defines "informant" as a person who, at the request of a law enforcement agency or officer observes persons enrolled in or employed by a program for the purpose of reporting the information his observations reveal to the officer or agency.

181. 61 Cal. App. 3d 584, 132 Cal. Rptr. 586 (1976).

182. *Id.* at 594-96, 132 Cal. Rptr. at 592-93. The California court noted that this interpretation is consistent with the history of 42 C.F.R. § 2.19 (1977), which reveals no intention to make the drug abuse prevention programs criminal sanctuaries.

183. 35 N.C. App. at 516, 241 S.E.2d at 871.

184. Brief for Defendant Appellant at 8-10, *State v. Bethea*, 35 N.C. App. 512, 241 S.E.2d 869 (1978), reveals only two cases decided nationwide construing this statute and regulation. *State v. Traas*, 343 So. 2d 1294 (Fla. Dist. Ct. App. 1977), does not provide much analysis of the issue; *Armenta v. Superior Court*, 61 Cal. App. 3d 584, 132 Cal. Rptr. 586 (1976), was relied upon by the court. The State relied primarily upon *Armenta*, but also mentioned *State v. White*, 169 Conn. 223, 363 A.2d 143 (1975), *cert. denied*, 423 U.S. 1025 (1978).

legislative intent in enacting this statute was clearly to protect the identity of participants in drug abuse prevention programs by statutorily protecting the confidentiality of program records.¹⁸⁵ In promulgating regulations to effectuate this purpose, the Secretary of Health, Education and Welfare concluded that a prohibition on the enrollment of informants in such facilities was necessary to guarantee this confidentiality.¹⁸⁶ The statute was not intended, however, to make these programs sanctuaries for criminal activity.¹⁸⁷ The courts have interpreted the statute in a manner consistent with this legislative intent.¹⁸⁸ Utilizing this approach, the court of appeals found that while the third-party informant could come within the definition of an informant under the regulations, the information obtained by him was not of the type the statute was intended to protect.¹⁸⁹ The information gathered was not a record within the definition set out in section 1175; it was merely information gathered by the third-party in a parking lot and was in no way connected with the medical records of the center itself.¹⁹⁰ Therefore, even if the information was obtained in violation of the regulation, it was not obtained in violation of the statute, and should not be suppressed.¹⁹¹

In adopting this reasoning, the court is effectively condoning the violation of a federal regulation. If a motion to suppress evidence wrongfully obtained under the regulations is denied because the evidence so obtained is not a record the statute itself intended to protect, an important remedy for violations of the regulation is removed.¹⁹² In so holding, the court of appeals is clearly subordinating the need for the confidentiality required to operate a successful rehabilitation center to the need to prevent the illegal sale of narcotic drugs.

G. Double Jeopardy

In *State v. Cannon*,¹⁹³ defendant entered a plea of guilty to a

185. See *State v. White*, 159 Conn. 223, 363 A.2d 143 (1975), cert. denied, 423 U.S. 1025 (1978).

186. See 42 C.F.R. § 2.19-1 (1977).

187. See *Armenta v. Superior Court*, 61 Cal. App. 3d 584, 593, 132 Cal. Rptr. 586, 596 (1976).

188. See, e.g., *id.*

189. 35 N.C. App. at 515-16, 241 S.E.2d at 871.

190. *Id.* For a discussion of what constitutes a record under the statute, see *State v. White*, 169 Conn. 223, 235-37, 363 A.2d 143, 150-51 (1975), cert. denied, 423 U.S. 1025 (1978).

191. 35 N.C. App. at 515-16, 241 S.E.2d at 871. See also *Armenta v. Superior Court*, 61 Cal. App. 3d 584, 132 Cal. Rptr. 586 (1976).

192. See Brief for Defendant Appellant at 9.

193. 38 N.C. App. 322, 248 S.E.2d 65 (1978).

charge of operating a motor vehicle without being licensed under G.S. 20-7.¹⁹⁴ Defendant then moved to dismiss a second case against him stemming from the same occurrence, operating a motor vehicle when his operator's license had been permanently revoked under G.S. 20-28.¹⁹⁵ Defendant contended that the plea of guilty to the first charge precluded the State from proceeding on the second because double jeopardy had attached.¹⁹⁶ The district court agreed with defendant, and the State appealed to the superior court, which found in favor of the State.¹⁹⁷ Defendant then appealed to the court of appeals.

While the prohibition against double jeopardy is not expressly set out in the North Carolina Constitution, it has been applied in this state as a fundamental principle of the common law.¹⁹⁸ One expression of the prohibition is the lesser degree rule, which states that "where the second indictment is for a crime greater in degree than the first, and where both indictments arise out of the same act . . . an acquittal or conviction for the first is a bar to a prosecution for the second."¹⁹⁹ In *Cannon*, the court of appeals found that G.S. 20-7 is not statutorily a lesser included offense of G.S. 20-28 and hence that conviction under both statutes is not barred on this ground.²⁰⁰

Another rule implementing the double jeopardy prohibition is that if the two offenses are the same in fact and law, then a defendant may not be prosecuted for both.²⁰¹ In making this determination, the "additional facts test" is applied.²⁰² This rule states that "[a] single act may be an offense against two statutes, and if each statute requires proof of an additional fact, which the other does not, an acquittal or conviction

194. N.C. GEN. STAT. § 20-7 (1977).

195. *Id.* § 20-28.

196. In the appeal to the court of appeals, defendant conceded that the charges had been properly joined, although objection had been raised on this ground in the district court. N.C. GEN. STAT. § 15A-926(c)(3) (1978) provides that joinder is not applicable when the defendant has pleaded guilty or no contest to the previous charge. In this case, defendant entered a plea of guilty to the first charge.

197. The district court found that the ultimate fact to be determined in each of the cases was whether defendant had in his possession a North Carolina operator's license; operating a motor vehicle without being licensed would therefore be a lesser included offense of § 20-28, so that jeopardy had attached after pleading guilty to the first charge.

198. *State v. Crocker*, 239 N.C. 446, 80 S.E.2d 243 (1954).

199. 38 N.C. App. at 324, 248 S.E.2d at 67 (quoting 15 N.C.L. REV. 53, 55 (1936)); see *State v. Bell*, 205 N.C. 225, 171 S.E. 50 (1933).

200. 38 N.C. App. at 325, 248 S.E.2d at 67. Section 20-7 is intended to apply when the defendant has not been issued a license or has let the license expire, while § 20-28 applies when the defendant has had his license revoked because of successive violations of the law.

201. See *State v. Barefoot*, 241 N.C. 650, 86 S.E.2d 424 (1958).

202. See *State v. Birkhead*, 256 N.C. 494, 124 S.E.2d 838 (1962).

under either statute does not exempt the defendant from prosecution and punishment under the other."²⁰³ The additional facts test is therefore bilateral in its application: to prosecute for both offenses, each offense must have some element not common to the other to make it a separate and distinct offense.²⁰⁴ The offenses charged in this case cannot pass this test. Failure to have a license is the only element of the G.S. 20-7 offense, yet it is also an element necessary in the G.S. 20-8 offense.²⁰⁵ Therefore, the court held that the two offenses are the same in fact and in law and the plea of double jeopardy should have been sustained.²⁰⁶

State v. Cox,²⁰⁷ another court of appeals decision, also dealt with double jeopardy. Cox was charged with armed robbery²⁰⁸ and pleaded not guilty. The evidence against him showed only that he drove the three other men involved in the robbery away from the scene of the crime. The trial judge directed a verdict of not guilty at the close of the State's evidence; defendant was then served with a warrant charging him with the offense of accessory after the fact.²⁰⁹ Defendant moved to dismiss this charge prior to trial on the ground that a trial on accessory charges would violate his double jeopardy protection; this motion, as well as a motion to dismiss on the basis of the joinder statute,²¹⁰ was denied.²¹¹ Defendant appealed from a conviction of guilty of accessory after the fact.

In support of his argument that a second trial would offend double jeopardy principles, defendant relied upon *Ashe v. Swenson*,²¹² in which the United States Supreme Court held that the principles of collateral estoppel are embodied in the fifth amendment protection against double jeopardy.²¹³ Collateral estoppel "means simply that when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot again be litigated between the same parties

203. *State v. Stevens*, 114 N.C. 873, 877, 19 S.E. 861, 862 (1894).

204. *State v. Nash*, 86 N.C. 650 (1882).

205. 38 N.C. App. at 326, 248 S.E.2d at 68.

206. *Id.* at 327, 248 S.E.2d at 69.

207. 37 N.C. App. 356, 246 S.E.2d 152, *appeal dismissed, cert. denied*, 295 N.C. 649, 248 S.E.2d 253 (1978).

208. Cox was charged under N.C. GEN. STAT. § 14-87 (Cum. Supp. 1977).

209. *See id.* § 14-7 (1969).

210. *Id.* § 15A-926(c)(2) (1978).

211. 37 N.C. App. at 358-59, 246 S.E.2d at 153.

212. 397 U.S. 436 (1970).

213. *See Survey of Developments in North Carolina Law, 1977*, 56 N.C.L. REV. 843, 977-80 (1978).

in any future lawsuit.”²¹⁴ Applying this rationale, the court of appeals found that the directed verdict on armed robbery foreclosed the State from subsequent prosecutions for armed robbery or any lesser included offense; it removed the issue whether the defendant participated as a principal in the armed robbery or whether he aided or abetted in its commission.²¹⁵ Accessory after the fact of armed robbery, however, is not a lesser included offense of armed robbery; the crime of accessory after the fact begins after the principal offense has been committed.²¹⁶ The directed verdict of not guilty of armed robbery therefore did not decide the question whether defendant had joined the criminal scheme after the robbery was complete and thus the court of appeals affirmed defendant’s conviction.²¹⁷

H. Doctrine of Recent Possession

In *State v. Musselwhite*,²¹⁸ the North Carolina Court of Appeals dealt with the doctrine of recent possession, the well-established doctrine that possession of stolen property soon after a theft permits an inference that the possessor is the thief, and if there is sufficient evidence that the property was stolen pursuant to a breaking and entering, that the possessor is also guilty of the breaking and entering.²¹⁹ In *Musselwhite*, the court refused to extend the doctrine to allow possession of recently stolen goods to be ground for a conviction of aiding and abetting. In this case, defendant and another man were charged with robbery with a firearm; defendant was convicted of aiding and abetting.²²⁰ The only evidence before the jury tended to establish unequivocally that the robbery was committed by the other man. The evidence

214. 397 U.S. at 443.

215. 37 N.C. App. at 360, 246 S.E.2d at 153-54.

216. See *State v. McIntosh*, 260 N.C. 749, 133 S.E.2d 652 (1963). *McIntosh* held that an acquittal of a charge of accessory after the fact of armed robbery will not support a plea of former jeopardy in a subsequent prosecution of the same defendant for armed robbery, because the two offenses are different in fact and in law.

217. 37 N.C. App. at 360, 246 S.E.2d at 154.

218. 36 N.C. App. 430, 245 S.E.2d 171 (1978).

219. See *State v. Eppley*, 282 N.C. 249, 192 S.E.2d 471 (1972); *State v. Blackmon*, 6 N.C. App. 66, 169 S.E.2d 472 (1969). The weight to be given this presumption depends upon the circumstances of the particular case. See *State v. Jackson*, 274 N.C. 594, 164 S.E.2d 369 (1968); *State v. Williams*, 219 N.C. 365, 13 S.E.2d 617 (1941). See generally 2 STRONG’S NORTH CAROLINA INDEX 3d *Burglary and Other Unlawful Breakings* § 5.4 (1978); 8 *id.* *Larceny* § 5.

220. One may be convicted of aiding and abetting in the offense of robbery if “he is near enough to render assistance if need be and to encourage the actual perpetration of the felony” or if he provides “a means by which the actual perpetrator may get away from the scene upon completion of the offense.” *State v. Lyles*, 19 N.C. App. 632, 635-36, 199 S.E.2d 699, 701-02, *cert. denied*, 284 N.C. 426, 200 S.E.2d 662 (1973).

against defendant proved only that he and the other man were later found driving in the same van. When the van was stopped, the other man was found to have the stolen money in his possession; a search of the van revealed a gun like the one stolen and another gun like the one used in the robbery so that both men were found to be in possession of stolen goods. The record was thus devoid of any evidence directly connecting defendant to the scene of the crime. The court held that the charge of aiding and abetting could not be submitted to the jury in reliance upon the presumption of theft arising from the possession of recently stolen goods.²²¹

This refusal to extend the doctrine of recent possession to allow a finding of guilty of aiding and abetting to be predicated solely upon possession of the stolen goods is reasonable when considered in light of the logic behind the presumption. In the usual case, the presumption is employed when there is no better evidence than possession of the stolen goods to connect the defendant to the crime. The presumption is justified nevertheless because of the certainty that someone committed the theft.²²² Hence, when the State's evidence unequivocally establishes that the larceny was committed by someone else, a critical ingredient of the presumption is destroyed.²²³

I. Obtaining Property or Services by False Pretenses

In *State v. Hines*,²²⁴ the North Carolina Court of Appeals directly addressed for the first time the question whether compensation to the victim precludes conviction of obtaining property or services by false pretenses.²²⁵ The court held that obtaining property "without compen-

221. 36 N.C. App. at 436, 245 S.E.2d at 175-76.

222. See *State v. Williams*, 219 N.C. 365, 13 S.E.2d 617 (1941).

223. See *State v. Cannon*, 218 N.C. 466, 11 S.E.2d 301 (1940). In *Cannon*, the evidence tended to prove that two men stole cigarettes and sold them to a third man who in turn sold them to defendant. The court held that while the recent possession of stolen property generally raises a presumption that the possessor is the thief, no such presumption can prevail when the State's evidence shows the larceny to have been committed by others and fails to connect the defendant in any way to the felonious taking.

224. 36 N.C. App. 33, 243 S.E.2d 782, *appeal dismissed, cert. denied*, 295 N.C. 262, 245 S.E.2d 779 (1978).

225. N.C. GEN. STAT. § 14-100 (Cum. Supp. 1977) provides in pertinent part:

Obtaining property by false pretenses.—(a) If any person shall knowingly and designedly by means of any kind of false pretense whatsoever, whether the false pretense is of a past or subsisting fact or of a future fulfillment or event, obtain or attempt to obtain from any person within this State any money, goods, property, services, chose in action, or other thing of value . . . , such person shall be guilty of a felony, and shall be imprisoned in the State's prison not less than four months nor more than 10 years, and fined, in the discretion of the court . . . , Provided, further, that it shall be sufficient in any indictment for obtaining or attempting to obtain any such money, goods, property, services, chose in

sation" to the victim is not an element of the crime that the State need allege or prove.²²⁶ The court further held that the requisite intent to defraud might be found even if the victim is adequately compensated in the economic sense, if that compensation is less than originally represented.²²⁷

Defendant in *Hines* led the prosecuting witness, largely through use of falsified documents, to believe that he was a state employee with authority to contract with her for a state job at a \$10,000 salary and benefits. In fact, defendant was not so employed or authorized, and the secretarial duties subsequently performed by the prosecuting witness under the impression she was starting her new state job were actually for defendant's benefit. Defendant did pay the prosecuting witness \$148 for the time she worked for him until she realized she had been deceived, and he also reimbursed her expenses incurred on a business trip.²²⁸

After his conviction, defendant contended on appeal that his motion for nonsuit should have been allowed because the services were not obtained without compensation.²²⁹ While recognizing that language in prior decisions suggested that "without compensation" had been recognized as an element,²³⁰ the court determined that the use of

action, or other thing of value by false pretenses to allege that the party accused did the act with intent to defraud, without alleging an intent to defraud any particular person, and without alleging any ownership of the money, goods, property, services, chose in action or other thing of value; and upon the trial of any such indictment, it shall not be necessary to prove either an intent to defraud any particular person or that the person to whom the false pretense was made was the person defrauded, but it shall be sufficient to allege and prove that the party accused made the false pretense charged with an intent to defraud.

Amended § 14-100 also expanded the violation to include an attempt to obtain property by false pretenses. *See State v. Grier*, 35 N.C. App. 119, 239 S.E.2d 870, *cert. denied*, 294 N.C. 442, 241 S.E.2d 844 (1978).

226. 36 N.C. App. at 40, 243 S.E.2d at 786.

227. *Id.* at 42, 243 S.E.2d at 788.

228. *Id.* at 34-35, 243 S.E.2d at 783.

229. *Id.* at 37, 243 S.E.2d at 785.

230. *See, e.g., State v. Agnew*, 33 N.C. App. 496, 236 S.E.2d 287 (1977), *rev'd on other grounds*, 294 N.C. 382, 241 S.E.2d 684 (1978):

The essential elements which the State must prove to the satisfaction of the jury beyond a reasonable doubt in order to convict one of the crime of false pretense are as follows: . . . "a false representation of a subsisting fact [or of a future fulfillment or event as provided in G.S. 14-100 as amended in 1975], calculated to deceive, and which does deceive, and is intended to deceive, whether the representation be in writing, or in words, or in acts, by which one man obtains value from another, without compensation . . ."

Id. at 500-01, 236 S.E.2d at 290 (quoting *State v. Davenport*, 227 N.C. 475, 495, 42 S.E.2d 686, 700 (1947)). *See also State v. Wallace*, 25 N.C. App. 360, 364, 213 S.E.2d 420, 423, *cert. denied*, 287 N.C. 468, 215 S.E.2d 628 (1975).

these words was merely dictum in those cases.²³¹ The court traced the "without compensation" phrase to a leading case concerning the offense, *State v. Phifer*,²³² and noted that the issue of the victim's compensation was neither discussed nor before the court in that decision. Further, the "without compensation" element appeared only in those cases immediately following *Phifer* that quoted directly from *Phifer* for a statement of the elements of the offense;²³³ cases from that period that cited but did not quote *Phifer* on the elements of the offense did not include the "without compensation" element.²³⁴ From this the court concluded that it had never been intended that failure of the victim to receive any compensation be an element of the crime. Additionally, no statutory provision has ever expressly required there be no compensation,²³⁵ and past convictions have been upheld although some compensation was received.²³⁶

Defendant in *Hines* also argued that if the compensation paid the victim was adequate in the fair market value sense, there could be no intent to defraud; therefore, the trial court's failure to instruct with regard to the adequacy of compensation was reversible error.²³⁷ In rejecting this argument, the court interpreted prior decisions upholding convictions in which either the victim had received some compensation,²³⁸ or the court had found it unnecessary to investigate the adequacy of the compensation,²³⁹ as aligning North Carolina with the majority view that no actual pecuniary loss to the victim need be shown

231. 36 N.C. App. at 40, 243 S.E.2d at 786.

232. 65 N.C. 321 (1871).

233. See, e.g., *State v. Mickle*, 94 N.C. 843 (1886); *State v. Hefner*, 84 N.C. 751 (1881).

234. See, e.g., *State v. Matthews*, 91 N.C. 635 (1884); *State v. Dickson*, 88 N.C. 643 (1883); *State v. Eason*, 86 N.C. 674 (1882).

235. 36 N.C. App. at 40, 243 S.E.2d at 786.

236. *Id.*

237. *Id.* Also addressing the element of intent in *State v. Tesenair*, 35 N.C. App. 531, 241 S.E.2d 877 (1978), the court of appeals held that a jury might find the necessary intent to deceive for conviction under § 14-100 quite apart from any intention to repay. In *Tesenair*, defendant purchased paint and supplies on a credit account he established by representing himself as his brother, who had a good credit rating. In refusing defendant's argument that this evidence could show no more than a failure to fulfill a promise to pay at a future date, the court followed what is the generally accepted view that "[w]hen the pretense is false, it is no defense that the defendant expected or intended to repay . . . the victim, should he be able to do so, or to pay before the deception is discovered." 2 WHARTON'S CRIMINAL LAW AND PROCEDURE § 610 (12th ed. 1957).

238. 36 N.C. App. at 40, 243 S.E.2d at 786; see *State v. Wallace*, 25 N.C. App. 360, 213 S.E.2d 420, cert. denied, 287 N.C. 468, 215 S.E.2d 628 (1975); *State v. Banks*, 24 N.C. App. 604, 211 S.E.2d 860 (1975).

239. 36 N.C. App. at 41, 243 S.E.2d at 787; see *State v. Howley*, 220 N.C. 113, 16 S.E.2d 705 (1941).

for the jury to find the requisite intent for conviction.²⁴⁰ The court defined the essence of G.S. 14-100²⁴¹ as the intentional false pretense and not the resulting economic harm to the victim, noting that the criminal law will intervene to protect the interests of the victims when services are obtained by a false representation even though some compensation is paid.²⁴² Although the victim in *Hines* had suffered an economic harm or prejudice in receiving less than represented, the court's holding that the gravamen of the offense is the intentional misrepresentation suggests that any "ultimate loss to the victim . . . is irrelevant to the purpose of the . . . statute."²⁴³

J. Breaking or Entering²⁴⁴ and Larceny²⁴⁵

In *State v. Keeter*,²⁴⁶ the court of appeals considered the question

240. 36 N.C. App. at 41, 243 S.E.2d at 737; see, e.g., *State v. Meeks*, 30 Ariz. 436, 247 P. 1099 (1926); *State v. Moss*, 194 Ark. 524, 108 S.W.2d 782 (1937); *People v. Bartels*, 77 Colo. 498, 238 P. 51 (1925); *State v. Green*, 144 Tex. Crim. 186, 106 S.W.2d 144 (1942); *State v. Sargent*, 2 Wash. 2d 190, 97 P.2d 692 (1940); *State v. Anderson*, 27 Wyo. 345, 196 P. 1047 (1921). But see *State v. McGhee*, 97 Ga. 199, 22 S.E. 589 (1895).

241. N.C. GEN. STAT. § 14-100 (Cum. Supp. 1977).

242. 36 N.C. at 42, 243 S.E.2d at 78.

243. *Id.* While many jurisdictions require that for conviction the victim must have been prejudiced in some way, it is unnecessary to show damage under statutes making the false representation itself the offense. See 2 WHARTON'S CRIMINAL LAW AND PROCEDURE § 602 (12th ed. 1957).

244. In *State v. Sneed*, 38 N.C. App. 230, 248 S.E.2d 658 (1978), the court of appeals defined "entry" as used in the offenses of breaking or entering and burglary. The court adopted the definition in BLACK'S LAW DICTIONARY 627 (rev. 4th ed. 1968), which defines an entry as "the least entry with the whole or any part of the body, hand, foot, or with any instrument or weapon, introduced for the purpose of committing a felony."

245. In *State v. Schultz*, 294 N.C. 281, 240 S.E.2d 451 (1978), the North Carolina Supreme Court held that bronze cemetery urns are not real property and the theft of such urns is properly the subject of common law larceny. This holding rejected the contention of defendant that the urns should be in the same category of property as tombstones, which are real property and not subject to common law larceny. See *State v. Jackson*, 218 N.C. 372, 11 S.E.2d 149 (1940) (tombstones classified as real property because of their permanence and hence cannot be subject of common law larceny).

In *State v. Carswell*, 296 N.C. 101, 249 S.E.2d 427 (1978), the North Carolina Supreme Court was presented with the issue of the sufficiency of a taking and asportation necessary to sustain a conviction of larceny. The court recognized that larceny is "a wrongful taking and carrying away of the personal property of another without his consent, . . . with intent to deprive the owner of his property and appropriate it to the taker's use fraudulently." *State v. Griffin*, 239 N.C. 41, 45, 79 S.E.2d 230, 232 (1953). Hence, larceny embraces both a taking and an asportation element. The asportation element can be satisfied by "a bare removal from the place in which [the thief] found the goods, though the thief does not quite make off with them." 4 W. BLACKSTONE, COMMENTARIES * 231. The taking requirement is met when the goods are severed from the possession of their owner, *State v. Roper*, 14 N.C. (3 Dev.) 473, 474 (1832), even if the possession and control by the thief is only for an instant. *State v. Jackson*, 65 N.C. 305 (1871). Thus, the act of picking up an air conditioner and laying it on the floor approximately six inches away is a sufficient taking and asportation to put the object briefly under the control of the defendant and to sever it from the owner's possession; defendant can be found guilty of larceny for these actions.

246. 35 N.C. App. 574, 241 S.E.2d 708 (1978).

whether the acceptance of a verdict of guilty of felonious larceny should be precluded when the jury is unable to reach a verdict on the charge of felonious breaking or entering upon which the larceny charge is predicated. Defendant was tried for felonious breaking or entering and felonious larceny. No verdict on the breaking or entering charge was reached; the jury then convicted defendant of felonious larceny.²⁴⁷

Defendant appealed this conviction on the ground that it was inconsistent with the rule of *State v. Jones*.²⁴⁸ In *Jones*, the North Carolina Supreme Court held that when a defendant is tried for breaking or entering and felonious larceny and the jury returns a verdict of not guilty of felonious breaking or entering and guilty of felonious larceny, it is improper for the trial judge to accept the verdict of guilty of felonious larceny unless the jury has been instructed on its duty to fix the value of the stolen property at more than \$200.²⁴⁹ In *Keeter*, this instruction was not given the jury.

The reason for this rule is that without a conviction of breaking or entering, felonious larceny cannot be found unless the State has proved in the alternative that the value of the property stolen was in excess of \$200. Felony larceny is committed when the State can prove that the value of the stolen property is greater than \$200; that the larceny is from the person or perpetrated pursuant to a breaking or entering; or that an explosive or incendiary device is utilized.²⁵⁰ Hence, if the jury acquits the defendant on the breaking or entering charge, the charge of felonious larceny cannot be predicated upon a breaking or entering. It therefore is "incumbent upon the State to prove beyond a reasonable doubt that the value of the stolen property was more than \$200; and this being an essential element of the offense, it is incumbent upon the trial judge to so instruct the jury."²⁵¹

247. *Id.* at 574, 241 S.E.2d at 709.

248. 275 N.C. 432, 168 S.E.2d 380 (1969).

249. Although the judgment of felonious larceny must be vacated in such a case, the verdict will stand and the case will be remanded for entering a sentence consistent with the verdict of guilty of misdemeanor larceny. *Id.* at 439, 168 S.E.2d at 385; *accord*, *State v. Teel*, 20 N.C. App. 398, 201 S.E.2d 733 (1974).

250. N.C. GEN. STAT. § 14-72 (Cum. Supp. 1977).

251. *State v. Cooper*, 256 N.C. 372, 380, 124 S.E.2d 91, 97 (1962). In *Cooper* defendant was convicted solely upon a charge of felonious larceny. The court held that if the State did not prove the value of the property stolen exceeded \$200, defendant was not guilty of a felony. This mandate with respect to instructions on value was clearly extended to cover the situation in which defendant is charged with both breaking or entering and felonious larceny in *State v. Holloway*, 265 N.C. 518, 144 S.E.2d 634 (1965), which held that if the State cannot prove a breaking or

The *Keeter* court extended this rule to the situation in which no verdict is reached on the breaking or entering charge. This is logically consistent with *Jones* since in neither case did the State prove beyond a reasonable doubt that defendant committed a breaking or entering.²⁵²

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VI. CRIMINAL PROCEDURE

A. Searches and Seizures

1. Vehicle Stops Under the Motor Vehicle Act¹

In *Keziah v. Bostic*,² the United States District Court for the Western District of North Carolina for the first time restricted the power of law enforcement officers to stop motor vehicles pursuant to G.S. 20-183(a)³ of the Motor Vehicle Act. G.S. 20-183(a) authorizes the discretionary stop of any vehicle on the state highways for a determination of whether it is being operated in violation of any provision of the Motor Vehicle Act.⁴ The court in *Keziah* found that prior interpretations of the statute, which allowed officers unlimited discretion in deciding which vehicles to stop, were unconstitutional under the fourth amendment.⁵

entering, a felony larceny charge must be based upon the property exceeding \$200 in value and the jury must be so instructed.

252. See Defendant Appellant's Brief at 7, *State v. Keeter*, 35 N.C. App. 574, 241 S.E.2d 733 (1978).

1. N.C. GEN. STAT. ch. 20 (1978).

2. 452 F. Supp. 912 (W.D.N.C. 1978).

3. N.C. GEN. STAT. § 20-183(a) (1978).

4. *Id.* The statute provides in pertinent part:

It shall be the duty of law-enforcement officers of the state and of each county, city, or other municipality to see that the provisions of this Article are enforced . . . , and any such officer shall have the power to arrest on sight or upon warrant any person found violating the provisions of this Article. Such officers within their respective jurisdictions shall have the power to stop any motor vehicle upon the highways of the State for the purpose of determining whether the same is being operated in violation of any of the provisions of this Article.

5. 452 F. Supp. at 915.

The arresting highway patrolman in *Keziah* first observed petitioner Keziah's vehicle turning out of a private drive onto a public highway. The officer watched Keziah in his rear view mirror, then turned his patrol car around to follow petitioner's vehicle. Petitioner drove one hundred and fifty feet down the highway and turned into another private drive. The officer followed him into the driveway and approached him. Petitioner, after refusing to display his driver's license or reveal his name at the officer's request, was told that he was under arrest for failure to display his license. Keziah resisted arrest, fought with the officer, and eventually escaped. The patrolman admitted he had no reason to believe petitioner had broken or was about to break any law, and that petitioner was not driving in any suspicious or unlawful manner. Keziah was later apprehended, convicted of assaulting an officer, and sentenced to a two year prison term.⁶

Keziah appealed his conviction, basing his appeal on the claim that he had been unconstitutionally stopped in the first instance, and thus that the officer had no authority to demand his license or to arrest him for failure to display it. Petitioner contended that he was therefore justified in resisting an illegal arrest.⁷ The North Carolina Court of Appeals held the initial stop justified as a routine license check under G.S. 20-183(a) and denied defendant's appeal.⁸

Keziah then sought habeas corpus relief in the federal district court, which disagreed with the court of appeals' interpretation of G.S. 20-183(a) and held the initial stop unconstitutional under the fourth amendment. In the process of reaching its holding the court found there was no doubt that an officer's stop and demand pursuant to G.S. 20-183(a) was a seizure within the meaning of the fourth amendment.⁹ The relevant question was whether the seizure in this case was unreasonable and thus a violation of the fourth amendment.¹⁰ Relying on *United States v. Montgomery*,¹¹ the court held that the license check

6. *Id.* at 913-14.

7. *Id.*

8. *State v. Keziah*, 24 N.C. App. 298, 300, 210 S.E.2d 436, 437 (1974).

9. 452 F. Supp. at 915. Petitioner's writ of habeas corpus was, however, denied on other grounds. Section 20-183(a) had been previously interpreted to authorize complete discretion on the part of officers; thus the arrest at that time was facially legal. Because the arrest was authorized by a statute arguably legal at the time, there was no right to resist arrest. Petitioner's conviction for assaulting a highway patrolman thus survived although the officer's initial stop and demand was illegal in fact. *Id.* at 916.

10. *Id.* at 914.

11. 561 F.2d 875 (D.C. Cir. 1977). In *Montgomery* police stopped a vehicle they had seen being driven around the neighborhood in order to check defendant's driver's license. They had no reason to believe defendant was breaking any traffic laws. When they found defendant did not

seizures authorized by G.S. 20-183(a) are only reasonable when they are actually routine, systematic stops for the purpose of enforcing the Motor Vehicle Act, or based on articulable suspicion that the Motor Vehicle Act is being violated.¹² When the stop is nominally for the purpose of enforcing the Motor Vehicle Act, but in reality is an excuse for investigating an officer's suspicions that fall short of probable cause to arrest, then the stop is unreasonable.¹³ The stop in *Keziah* clearly fell into the latter category.

The court in *Keziah* expressly chose to ignore prior interpretations of G.S. 20-183(a) by the North Carolina Supreme Court¹⁴ and the United States Court of Appeals for the Fourth Circuit.¹⁵ Both courts had declared constitutional the unlimited discretion vested in law enforcement officers to stop vehicles for license checks under G.S. 20-183(a).¹⁶ The North Carolina Supreme Court had previously held that such stops were not seizures under the fourth amendment and thus not subject to any constitutional limits of reasonableness.¹⁷

The *Keziah* court relied instead on the pioneer decision of the United States Court of Appeals for the District of Columbia Circuit in *United States v. Montgomery*.¹⁸ The *Montgomery* court noted that the

have his license, the officers checked whether he had been issued a license and discovered an outstanding traffic violation against him. Defendant was arrested and a search incident to his arrest turned up three weapons. The United States Court of Appeals for the District of Columbia Circuit reversed defendant's conviction for carrying concealed weapons, holding the initial stop unconstitutional. *Id.* at 877.

12. 452 F. Supp. at 915. The articulable suspicion justification for stops that intrude less on privacy rights than do arrests was first articulated in *Terry v. Ohio*, 392 U.S. 1 (1968). It has been further applied in cases involving vehicle stops for the purpose of enforcing border patrol acts. See *United States v. Ortiz*, 422 U.S. 891 (1975); *United States v. Brignoni-Ponce*, 422 U.S. 873 (1975).

13. 452 F. Supp. at 915.

14. *State v. Allen*, 282 N.C. 503, 194 S.E.2d 9 (1973). In *Allen*, police observed a parked car in a nonresidential area. Officers saw two men run from a business area, get into a car, and drive away. The officers pursued the car and stopped it to check the licenses of the occupants. During this procedure a bag of stolen money was observed in plain view and seized. The court upheld the constitutionality of § 20-183(a) and upheld defendants' conviction for robbery. *Id.* at 505-08, 194 S.E.2d at 12-13.

15. *United States v. Kelley*, 462 F.2d 372 (4th Cir. 1972). In *Kelley*, law enforcement officers were called to observe a rented truck that had been parked in a public area for some time. They observed defendants get into the truck and drive away without behaving in any suspicious manner. The officers attempted to stop the truck to check defendants' licenses and, after a chase, arrested defendants. A search of the truck uncovered stolen goods, and defendants were convicted of their possession. The original attempt to stop was upheld as constitutional under § 20-183(a).

16. *State v. Allen*, 282 N.C. 503, 511, 194 S.E.2d 9, 15 (1973); *United States v. Kelley*, 462 F.2d 372, 374 (4th Cir. 1972).

17. *State v. Allen*, 282 N.C. 503, 508, 194 S.E.2d 9, 13 (1973).

18. 561 F.2d 875 (D.C. Cir. 1977). Significantly, the court in *Montgomery* expressly criticized the Fourth Circuit opinion in *United States v. Kelley*, 462 F.2d 372 (4th Cir. 1972). 561 F.2d at 884 n.16.

United States Supreme Court has been careful not to rule on the constitutionality of vehicle stops pursuant to the enforcement of motor vehicle acts,¹⁹ but that most lower courts have held that such stops are seizures within the meaning of the fourth amendment.²⁰ These courts disagree, however, on the standard of fourth amendment reasonableness that should apply to the stops.²¹ The *Montgomery* court thus looked for guidance to Supreme Court cases involving vehicle stops for the purpose of ascertaining if illegal aliens are entering the country in violation of the border patrol acts.²² The Court in these cases developed a two-part test for constitutional reasonableness of border patrol stops. To avoid violating the fourth amendment the stop must be part of a systematic, routine program of vehicle stops,²³ or based on articulable suspicion that the occupants of the vehicle were violating the border patrol acts.²⁴ Acknowledging the similarity in border patrol and motor vehicle act stops and their identical potential for abuse, the *Montgomery* court applied this two-part test to motor vehicle act stops,²⁵ despite the Supreme Court's express exclusion of motor vehicle stops from its holdings in the border patrol cases.

By accepting the *Montgomery* application of the two-part test, the *Keziah* court imposes a stricter standard for the application of G.S. 20-183(a) than had previously been required. The *Keziah* ruling will serve

19. 561 F.2d at 881; see *United States v. Martinez-Fuerte*, 428 U.S. 543, 560 n.14 (1976); *United States v. Brignoni-Ponce*, 422 U.S. 873, 883 n.8 (1975); *United States v. Ortiz*, 422 U.S. 891, 897 n.3 (1975).

20. The United States Supreme Court has held in situations other than stops pursuant to motor vehicle acts that the stop of a moving vehicle, even for a brief period, involves a seizure within the meaning of the fourth amendment. See *United States v. Brignoni-Ponce*, 422 U.S. 873, 878-82 (1975); *Terry v. Ohio*, 392 U.S. 1, 16-19 (1968).

21. Decisions that disapprove vesting unlimited discretion in officers to single out which vehicles to stop include *State v. Ochoa*, 112 Ariz. 582, 544 P.2d 1097 (1976); *People v. Ingle*, 36 N.Y.2d 413, 330 N.E.2d 39, 369 N.Y.S.2d 67 (1975). Other courts have reserved judgment on discretionary stops. See *United States v. Cupps*, 503 F.2d 277, 280 n.7 (6th Cir. 1974); *United States v. De Marco*, 488 F.2d 828, 831 n.6 (2d Cir. 1973). Some courts have upheld selective stops to enforce the motor vehicle laws. See *United States v. Croft*, 429 F.2d 884, 886 (10th Cir. 1970); *Palmore v. United States*, 290 A.2d 573 (D.C.), *aff'd on jurisdictional grounds only*, 411 U.S. 389 (1972); *State v. Holmberg*, 194 Neb. 337, 231 N.W.2d 672 (1975); *State v. Gray*, 59 N.J. 563, 285 A.2d 1 (1971).

22. See *United States v. Martinez-Fuerte*, 428 U.S. 543 (1976) (routine systematic stops of vehicles at border patrol checkpoints held constitutionally reasonable); *United States v. Ortiz*, 422 U.S. 891 (1975) (discretionary searches of vehicles going through fixed border patrol checkpoint unconstitutional); *United States v. Brignoni-Ponce*, 422 U.S. 873 (1975) (border patrols may not stop individual vehicle in border area without reasonable basis for suspecting that vehicle being occupied by illegal aliens).

23. The systematic, routine program may consist of stops at fixed checkpoints or a planned system of random stops. *United States v. Montgomery*, 561 F.2d at 883-84.

24. See *United States v. Brignoni-Ponce*, 422 U.S. 873, 884 (1975).

25. 561 F.2d at 881.

to curb the abusive use of G.S. 20-183(a) as an investigative tool for law enforcement officers by subjecting each license check stop to constitutional scrutiny under the fourth amendment. The *Keziah* opinion further represents a major step in the recent trend in North Carolina toward placing some limits on G.S. 20-183(a) stops.²⁶ Earlier decisions had limited the scope of permissible actions by officers after making the stop. *Keziah* for the first time places the stop under fourth amendment scrutiny. In so doing, the court strengthened the privacy rights of individuals when in motor vehicles.²⁷

2. Execution of a Search Warrant

The North Carolina Court of Appeals in three cases sought to clarify the requirements for legal execution of a search warrant. The first, *State v. Brown*,²⁸ dealt with the requirement that an officer must give notice of his identity and purpose before entering the premises to execute a search warrant. *State v. Woodard*²⁹ delineated the circumstances in which officers acting pursuant to a general warrant to search the premises can also search subunits within the premises. Last, in *State v. Long*,³⁰ the court examined the authority of officers to search persons found on the premises described in the warrant, but who are not named in the warrant.³¹

26. See *State v. Blackwelder*, 34 N.C. App. 352, 238 S.E.2d 190 (1977). The court in *Blackwelder* placed limits on permissible searches incident to stops under the Motor Vehicle Act. The court held that the power to stop did not include the power to search, and evidence seized under the plain view exception was limited to that evidence in plain view from where the officer had a legal right to be.

The present reach of the *Blackwelder* holding is uncertain after a North Carolina Court of Appeals decision this year. In *State v. Thompson*, 37 N.C. App. 628, 246 S.E.2d 827 (1978), police approached a van parked on a public boat dock to check the identity of the occupants. They had no reason to suspect the occupants were committing or about to commit a crime. In leaning over the passenger seat to get identification from the driver, the officer observed hashish hidden under the dash board in a recessed area. The court upheld the seizure of the hashish under the plain view exception to the search warrant requirement, distinguishing *Blackwelder* by saying the officer had a right to be where he was in this case. Judge Erwin dissented, finding that the initial approach was unlawful and the plain view exception inapplicable. *Id.* at 637-38, 246 S.E.2d at 833-34 (dissenting opinion).

The officer's approach of the vehicle in *Thompson* is exactly the sort of activity the *Keziah* court declared unconstitutional. Approaching the van was a discretionary move by the officers; they had no articulable suspicion that the occupants might be engaged in criminal activity.

27. See Note, *Automobile License Checks and the Fourth Amendment*, 60 VA. L. REV. 666 (1974).

28. 35 N.C. App. 634, 242 S.E.2d 184 (1978).

29. 35 N.C. App. 605, 242 S.E.2d 201 (1978).

30. 37 N.C. App. 662, 246 S.E.2d 846, cert. denied, 295 N.C. 736, 248 S.E.2d 866 (1978).

31. In another case, *State v. Richards*, 294 N.C. 474, 242 S.E.2d 844 (1978), the North Carolina Supreme Court reemphasized its position on when items not particularly described in a search warrant may be seized during a search pursuant to the warrant. The general rule is that items not

G.S. 15A-249³² requires an officer executing a search warrant to give notice of his identity and purpose before entering the premises. In *State v. Brown* officers were executing a warrant authorizing the search of defendant's residence for marijuana.³³ Knowing that marijuana could easily be destroyed, the officers devised a plan to gain quick entry into defendant's house and prevent destruction of the evidence. A chase was staged in which a sheriff's car, with lights flashing and siren blowing, pursued an unmarked car and stopped in front of defendant's house. When defendant opened his door to view the commotion, an officer dressed in jeans and sandals asked if he could use the phone. When defendant refused the officer pushed his way inside the house and discovered several bags of marijuana.³⁴

At trial defendant sought to suppress the evidence obtained in the search on the ground that it was seized in violation of G.S. 15A-249. The trial judge denied defendant's motion to suppress, relying on an exception to the notice of identification and purpose requirement for searches that seek easily destructible evidence.³⁵ The court of appeals

particularly described in a warrant cannot be seized while executing that warrant without violating the fourth amendment. *Marron v. United States*, 275 U.S. 192 (1927). An exception to this rule applies when the evidence of criminal activity falls within the plain view of the executing officer during the search and is discovered inadvertently. *Coolidge v. New Hampshire*, 403 U.S. 443, 465-71 (1971). The meaning of "inadvertently" has been the source of considerable controversy. See generally *The Supreme Court, 1970 Term*, 85 HARV. L. REV. 3, 244-46 (1971).

In *Richards*, officers were searching defendant's residence for a murder weapon described in the search warrant. In the course of the search police discovered two other weapons that were admitted into evidence against defendant. The court held that the weapons were inadvertently found in plain view, and admissible as evidence against defendant. In reaching this holding the court interpreted the inadvertence doctrine as excluding evidence only when the officers knew the location of the evidence and intended to seize it. 294 N.C. at 489, 242 S.E.2d at 854-55. The decision was significant in its interpretation of inadvertence; it was the first time the supreme court had defined the term directly; prior cases had merely mentioned without defining the term. See *State v. Rigsbee*, 285 N.C. 708, 713-14, 208 S.E.2d 656, 660-61 (1974). North Carolina commentators have likewise avoided interpreting the doctrine. See, e.g., 1 STANSBURY'S NORTH CAROLINA EVIDENCE § 121a, at 372 (H. Brandis rev. 1973) [hereinafter cited as STANSBURY]. For a discussion of alternative interpretations, see *The Supreme Court, 1970 Term, supra*, at 244-46.

32. N.C. GEN. STAT. § 15A-249 (1978) provides:

The officer executing a search warrant must, before entering the premises, give appropriate notice of his identity and purpose to the person to be searched, or the person in apparent control of the premises to be searched. If it is unclear whether anyone is present at the premises to be searched, he must give the notice in a manner likely to be heard by anyone who is present.

33. 35 N.C. App. at 634, 242 S.E.2d at 185.

34. *Id.* at 634-35, 242 S.E.2d at 185.

35. Judge Lupton found that

the defendant was not prejudiced by this deviation from the requirements of North Carolina General Statute 15A-249 since the reason for complying with the above statute is to show that the officers were not trespassers and that the deviation from lawful conduct was minor, and that the lawfulness of the deviation was somewhat justified by the word received through the confidential informant that the contraband may be destroyed. . . .

reversed and ordered the evidence suppressed. The court refused to authorize an exception to G.S. 15A-249 that would be applicable whenever there was a possibility that the evidence would be destroyed.

The court based its decision solely on an interpretation of G.S. 15A-249 and G.S. 15A-251³⁶ of the Criminal Procedure Act,³⁷ admitting that neither federal nor state constitutional standards would require exclusion of the evidence.³⁸ According to the court, the statutory scheme reveals a design to permit unannounced forcible entries only when giving notice would endanger the life or safety of any person.³⁹ This accords with the legislative intent that can reasonably be inferred from the history of the statutes in question. In drafting the Criminal Procedure Act, the North Carolina Criminal Code Commission submitted as part of the proposed Act a provision that would have authorized exceptions to the notice and purpose requirement in certain limited situations.⁴⁰ One proposed situation was the one in which there was probable cause to believe that giving notice would cause the destruction of evidence and the officers obtained prior judicial authorization to proceed without giving notice.⁴¹ The General Assembly failed

Id. at 636, 242 S.E.2d at 186 (quoting trial court).

36. N.C. GEN. STAT. § 15A-251 (1978), *quoted in* note 42 *infra*.

37. 35 N.C. App. at 637, 242 S.E.2d at 186-87.

38. *See* *Ker v. California*, 374 U.S. 23 (1963) (entry held legal when officers acting without a warrant let themselves into defendant's apartment with pass key, identifying themselves only after approaching defendant); *State v. Watson*, 19 N.C. App. 160, 198 S.E.2d 185 (1973) (when officer had reason to believe evidence was being destroyed, he did not need to give notice of his identity and purpose).

39. 35 N.C. App. at 636, 242 S.E.2d at 186.

40. H. 296, N.C. Gen. Assembly, 1973 Sess., *reprinted in* CRIMINAL CODE COMMISSION, LEGISLATIVE PROGRAM AND REPORT TO THE GENERAL ASSEMBLY OF NORTH CAROLINA 19-20 (1973). *See also* Defendant Appellant's Brief at 5-6, *State v. Brown*, 35 N.C. App. 634, 242 S.E.2d 184 (1978).

41. Proposed N.C. GEN. STAT. § 15A-250 provided that:

An officer may execute a search warrant without the prior notice required by G.S. 15A-249 if:

- (1) The officer has probable cause to believe that the notice required by G.S. 15A-249 would endanger the life or safety of any person; or
- (2) An order authorizing execution without notice has been obtained from any judge. The application by an officer for such an order must include a statement of facts establishing probable cause to believe that the notice required by G.S. 15A-249 is likely to endanger the life or safety of any person or . . . is likely to result in the destruction or disposal of items subject to seizure. If the judge finds that there is probable cause to believe that either of these conditions is met, he may issue an order permitting execution of the warrant without notice. The fact that items subject to seizure are easily destructible or disposable does not in itself constitute an independently sufficient basis for concluding that there is probable cause to believe that the giving of notice will result in destruction or disposal

H. 296, N.C. Gen. Assembly, 1973 Sess., *reprinted in* CRIMINAL CODE COMMISSION, *supra* note 40. Even this proposed statute would have restricted police activity far more than the federal or state

to adopt this provision, and instead granted officers the authority to enter without notice only when there is probable cause to believe that giving notice would endanger the safety or life of any person.⁴² The General Assembly's failure to adopt the proposed statute cast uncertainty on the fate of a prior judicially created exception that notice would not be required if it would cause the destruction or disposition of evidence.⁴³ The court in *State v. Brown* removed all uncertainty, stating that the prior judicial exception was overruled by the Criminal Procedure Act.⁴⁴ The court thus established a hard line in North Carolina against "no-knock" entries, which have caused considerable controversy throughout the country.⁴⁵

Considering the fact situation in *Brown*, the court appears to prohibit gaining entry by false notice of identity as well as gaining entry without giving any notice.⁴⁶ Courts have, however, declared entries legal in certain situations in which the officers failed to comply fully with the requirements of G.S. 15A-249 when, for example, the door was ajar,⁴⁷ or when officers identified themselves but did not state their purpose before forcing entry.⁴⁸ The *Brown* holding does not disturb these

constitutions mandate. Note that the proposed statute would have required a judge to give approval to the unannounced entry. A warrant need only be approved and issued by a magistrate. By requiring a judge the Commission sought to subject such requests to individual scrutiny and to prevent them from becoming a part of standard form warrant applications. Nakell, *Proposed Revisions of North Carolina's Search and Seizure Law*, 52 N.C.L. REV. 277, 344-48 (1973).

42. N.C. GEN. STAT. § 15A-251 (1978) deals with entry by force and provides:

An officer may break and enter any premises or vehicle when necessary to the execution of the warrant if:

- (1) The officer has previously announced his identity and purpose as required by 15A-249 . . . or
- (2) The officer has probable cause to believe that the giving of notice would endanger the life or safety of any person.

43. See Dellinger, *Subchapter II. Law Enforcement and Criminal Investigation*, 10 WAKE FOREST L. REV. 363, 370-73 (1974); Nakell, *supra* note 41.

44. 35 N.C. App. at 637, 242 S.E.2d at 186-87 (overruling *State v. Watson*, 19 N.C. App. 160, 198 S.E.2d 185, *cert. denied*, 284 N.C. 124, 199 S.E.2d 662 (1973) insofar as it is inconsistent with *Brown*).

45. See Nakell, *supra* note 41, at 337-48.

46. Many courts have held that an officer obtaining entry by ruse may not be required to announce his authority and purpose. See *United States v. Beale*, 445 F.2d 977, 978 (5th Cir. 1971), *cert. denied*, 404 U.S. 1026 (1972) (hotel manager knocked on defendant's door and announced only his presence; officers entered and arrested defendant when he opened the door); *United States v. Syler*, 430 F.2d 68, 70 (7th Cir. 1970) (officer called out "gas man" at defendant's door and, when defendant came to the door, pushed his way inside); *Ponce v. Craven*, 409 F.2d 621, 626 (9th Cir. 1969) (hotel manager announced there was a call for woman sharing room with defendant, when woman opened door, officers entered and arrested defendant). These cases suggest that in many jurisdictions giving notice of false identity may satisfy the identity requirement. Any notice, even a false one, is less intrusive than no notice.

47. *State v. Brissenden*, 23 N.C. App. 730, 209 S.E.2d 539 (1974).

48. *State v. Sutton*, 34 N.C. App. 371, 238 S.E.2d 305 (1977).

decisions.

Another problem situation in executing a search warrant may arise once officers have legally gained entry to the premises described in the warrant. At this point they occasionally find that the general structure is divided into several subunits, each under the control of someone other than the owner. In this situation the general rule is that the warrant is valid to search a subunit only if the subunit is particularly described in the warrant.⁴⁹ The court of appeals in *State v. Woodard*⁵⁰ for the first time established the exceptions to the general rule that should be recognized by North Carolina courts.

In *Woodard*, officers obtained a general warrant to search for stolen clothing in a residence owned by defendant's uncle, and in which defendant rented a room. Prior to conducting the search, the officers read the warrant to the owner and gave him a copy. The officers then proceeded to search the house, including the bedroom in which defendant was asleep on a bed. The police found new clothes in the closet, seized them, and handed defendant's uncle an inventory of the items seized. Defendant shared the room with the owner's son, and both defendant and the son used the closet in which the stolen clothes were found. The police were never notified during the search that defendant rented the room or that the room was not under the owner's control.⁵¹

Defendant sought to suppress the evidence of the seized clothes at trial on the ground that his room was a subunit of the residence and not particularly described in the search warrant. The trial court denied the motion to suppress. Affirming, the court of appeals held that two exceptions to the rule that a warrant must particularly describe a subunit were applicable in this case.⁵² The first applies when the premises searched are not under the exclusive control of the person against whom the seized evidence is sought to be admitted; the second is applicable when the officers do not know or have reason to know the defendant has exclusive control over the subunit.⁵³

One question left unanswered by the *Woodard* court is the precise definition of exclusive control. It is clear that when two people have equal rights to use or occupy the premises, either may consent to a

49. *State v. Mills*, 246 N.C. 237, 98 S.E.2d 329 (1957).

50. 35 N.C. App. 605, 242 S.E.2d 201 (1978).

51. *Id.* at 605-07, 242 S.E.2d at 202-03.

52. *Id.* at 610, 242 S.E.2d at 204-05.

53. *Id.* There is a split of authority on the issue. *See* Annot., 11 A.L.R.3d 1330 (1967).

search of the premises.⁵⁴ It is unclear to what degree one person must have a greater right to use or occupy the premises before exclusive control is said to exist. The *Woodard* court indicated only that exclusive control exists when both persons with an interest in the property recognize that one of them has exclusive control.⁵⁵

The result of the court's holding is that in any situation in which the officers are ignorant of the character of possession of the premises, they may undertake the search without fearing that a warrant particularly describing the premises should be obtained. The court did not delineate the circumstances that would cause it to impose an affirmative duty on the officer to investigate the character of possession of the premises. Unless such a duty is imposed whenever control over the premises is uncertain, officers will be encouraged to prevent any opportunity for learning the character of possession from arising.⁵⁶ This result seems inconsistent with the policy in search and seizure cases to give "priority to the rights of the tenant in possession."⁵⁷

Another court of appeals case, *State v. Long*,⁵⁸ dealt with the extent to which an officer executing a valid search warrant may search persons who are found on the premises but are not described in the warrant. In *Long*, officers were issued a warrant authorizing the search of a residence, the sergeant and his wife who lived there, and any other military personnel present on the premises.⁵⁹ When officers entered to conduct the search they discovered defendant, a civilian, on the premises. Before the search began a limited pat down search was made of everyone present, including defendant. In searching defendant, the officer not only patted defendant's clothing, he also reached inside de-

54. *State v. Melvin*, 32 N.C. App. 772, 233 S.E.2d 636 (1977).

55. 35 N.C. App. at 608, 242 S.E.2d at 204. This is the basis on which the court distinguished *State v. Mills*, 246 N.C. 237, 98 S.E.2d 329 (1957). In *Mills*, defendant leased a room from the owner of the premises. Defendant shared possession of the room with several others. The court found that lessor and defendant agreed that defendant controlled the premises, thus exclusive control was found.

56. See Brief for Appellant, *State v. Woodard*, 35 N.C. App. 605, 242 S.E.2d 201 (1978).

57. *In re Dwelling of Properties, Inc.*, 24 N.C. App. 17, 22, 210 S.E.2d 73, 76 (1974).

58. 37 N.C. App. 662, 246 S.E.2d 846, cert. denied, 295 N.C. 736, 248 S.E.2d 866 (1978).

59. The warrant in this case was an "Authority to Search and Seize" issued by a commanding officer of a military base. *Id.* at 664, 246 S.E.2d at 848. Defendant challenged the validity of this warrant as not being issued by a neutral magistrate and not being issued upon a written affirmation as required in N.C. GEN. STAT. § 15A-244 (1978). The court found that commanding officers qualify as neutral magistrates for the purpose of determining probable cause. See *United States v. Banks*, 539 F.2d 14 (9th Cir.), cert. denied, 429 U.S. 1024 (1976). In addition, when the search is made of property in the possession or control of a person under the command of the issuing officer, as the sergeant in this case was, the warrant is valid although based on oral application. 37 N.C. App. at 667, 246 S.E.2d at 850. The remainder of the opinion proceeded on the finding that the warrant was valid.

defendant's boot to the foot. While reaching in the boot the officer felt a sharp pointed object which he thought was a knife. He pulled the object out and discovered it was a plastic bag containing a needle, packets of heroin, and other drug related objects. No further search of defendant was made, and he was turned over to county law enforcement officers and convicted of possession with intent to sell.⁶⁰

Defendant contended that the heroin should have been suppressed due to its seizure in violation of G.S. 15A-255⁶¹ and G.S. 15A-256.⁶² G.S. 15A-255 provides that an officer executing a search warrant may search for weapons by a patting of the clothing of those on the premises, if he has reason to believe that the safety of any person is in danger.⁶³ If a search of the premises and persons described in the warrant fails to produce the evidence sought, G.S. 15A-256 permits an officer to then search any person who was present at the time of his entry to the extent necessary to uncover the evidence.⁶⁴ Neither of these statutes authorized the search of defendant's boot in *Long*. G.S. 15A-255 expressly limits a weapons search to an external pat down of the clothing. G.S. 15A-256 did not apply because defendant was searched before the search of the premises. The court found, however, that exclusion of the evidence was not required because neither of the statutory violations was "substantial" within the meaning of G.S. 15A-974(2),⁶⁵ which provides that evidence must be excluded if obtained in violation of the

60. 37 N.C. App. at 663-65, 246 S.E.2d at 848-49.

61. N.C. GEN. STAT. § 15A-255 (1978).

62. *Id.* § 15A-256.

63. *Id.* § 15A-255 provides:

An officer executing a warrant directing a search of premises . . . may, if the officer reasonably believes that his safety or the safety of others then present so requires, search for any dangerous weapons by an external patting of the clothing of those present. If in the course of such a frisk he feels an object which he reasonably believes to be a dangerous weapon, he may take possession of the object.

64. *Id.* § 15A-256 provides:

An officer executing a warrant directing a search of premises . . . may detain any person present for such time as is reasonably necessary to execute the warrant. If the search of such premises . . . and of any persons designated as objects of the search in the warrant fails to produce the items named in the warrant, the officer may then search any person present at the time of the officer's entry to the extent reasonably necessary to find property particularly described in the warrant which may be concealed upon the person

The North Carolina statute is unusual in its limits on the search of persons on the premises. The majority view is that if the search is based on probable cause to search the premises for a type of contraband easily hidden, then complete searches of all individuals on the premises would be authorized. *See, e.g., Samuel v. State*, 222 So. 2d 3 (Fla. 1969); *Willis v. State*, 122 Ga. App. 455, 177 S.E.2d 487 (1970); *State v. Loudermilk*, 208 Kan. 893, 494 P.2d 1174 (1972). *See also United States v. Johnson*, 475 F.2d 977 (D.C. Cir. 1973).

65. N.C. GEN. STAT. § 15A-974(2) (1978).

United States or North Carolina constitutions or in substantial violation of the Criminal Procedure Act.⁶⁶

To determine whether the search violated the United States Constitution, the court turned to the United States Supreme Court decision in *Terry v. Ohio*.⁶⁷ In *Terry*, the Court outlined the "stop and frisk" doctrine, stating that an officer who stops a person for questioning is permitted to frisk that person to the extent necessary to discover weapons, provided the officer has reason to believe the person is armed and dangerous.⁶⁸ The *Terry* rule is, therefore, not limited to a patting of clothing. The court in *Long* found that the search inside defendant's boot was necessary to discover weapons hidden there, and was therefore reasonable under *Terry* and the fourth amendment.⁶⁹ Even though the *Terry* decision dealt only with stop and frisk procedures that by their nature create an exigent situation for an officer, the court in *Long* saw no difficulty in applying the *Terry* holding to a search pursuant to a warrant in which several officers were present. Thus, because the search was in compliance with the fourth amendment, and not in substantial violation of the Criminal Procedure Act, the court set aside the lower court's order suppressing the fruits of the search.⁷⁰

B. *Limits to an Accused's Miranda Rights*

In two cases North Carolina courts further defined the limits of an accused's rights established by the United States Supreme Court decision in *Miranda v. Arizona*.⁷¹ The protections of the *Miranda* opinion apply only when an accused is in custody and being interrogated.⁷² The brief definition of custodial interrogation found in *Miranda* left much room for judicial interpretation.⁷³ One question left unanswered was the extent to which a law enforcement officer's nonverbal conduct can be defined as interrogation for purposes of the *Miranda* doctrine.

66. *See id.*

67. 392 U.S. 1 (1968) (frisk of defendant reasonable under fourth amendment because officer had reason to suspect defendant was armed and nothing in his initial encounter with defendant dispelled this suspicion).

68. 37 N.C. App. at 670, 246 S.E.2d at 852. The court appears to be authorizing any search that would constitute a permissible "frisk" under the holding in *Terry*, thus indicating that § 15A-255 will also be expanded in other situations.

69. *See* 37 N.C. App. at 669, 246 S.E.2d at 851.

70. 37 N.C. App. at 671, 246 S.E.2d at 852.

71. 384 U.S. 436 (1966).

72. *See id.* at 445.

73. The *Miranda* opinion states: "By custodial interrogation, we mean questioning initiated by law enforcement officers after a person has been taken into custody or otherwise deprived of his freedom of action in any significant way." *Id.* at 444.

This was the question presented to the North Carolina Supreme Court in *State v. McLean*.⁷⁴

In *McLean*, officers had obtained a warrant for defendant's arrest on a charge of rape. They had recovered a checkbook with defendant's name on it, defendant's driver's license, and a hat from the scene of the rape. The officers found defendant in jail, under arrest for an unrelated offense.⁷⁵ Defendant was ushered into an interrogation room at the jail with an officer who had the warrant for defendant's arrest in his pocket. Instead of arresting defendant at that time, the officer placed one of the checks found at the rape scene in plain view of defendant. The officer said nothing. Defendant eventually took hold of the check and admitted it belonged to him.⁷⁶ The officer, still without speaking, placed the hat found at the rape scene into defendant's view. Defendant began to act nervous, his hand quivered, and eventually he stated "What's that man?" and "I liked to have been a free man."⁷⁷ During the approximately twenty minute episode the officer observed defendant but said nothing. Only after defendant's incriminating statements did the officer read the arrest warrant, arrest defendant, and advise him of his rights as required by *Miranda*.⁷⁸

At trial, defendant sought to bar any testimony relating to his statements or actions during the silent confrontation with the officer, on the ground that the confrontation was an in-custody interrogation and defendant had not been advised of his constitutional rights, in violation of *Miranda*. The trial court denied the motion, finding that defendant's statements were voluntary and not in response to in-custody interrogation.⁷⁹

The North Carolina Supreme Court affirmed, finding that because the officer's behavior was not inquisitional in nature, defendant's statements were voluntary and not elicited by interrogation. In reaching its holding the court noted the considerable disagreement among jurisdictions about what constitutes interrogation.⁸⁰ In view of this controversy

74. 294 N.C. 623, 242 S.E.2d 814 (1978).

75. The unrelated offense was tampering with an automobile. The prosecutor brought out in the cross-examination that defendant was trying to get into a car occupied by a female not known to the defendant. The court upheld the introduction of this evidence for impeachment purposes. *Id.* at 633-34, 242 S.E.2d at 820-21.

76. *Id.* at 626, 242 S.E.2d at 816. Defendant said "This is my check. I wrote this check when I did not know how to write checks. However, the check is good." *Id.*

77. *Id.* at 626, 242 S.E.2d at 816-17.

78. *Id.* at 626-27, 242 S.E.2d at 816-17. See also Defendant Appellant's Brief at 6.

79. 294 N.C. at 627, 242 S.E.2d at 817.

80. Cases in other jurisdictions that allow officers wide leeway before an interrogation is

the court refused to delineate a strict definition of interrogation, but rather decided to leave the issue to case-by-case analysis.⁸¹ The factors the court indicated it will consider include the degree to which the officer's conduct is inquisitional in nature, the degree to which the accused is placed under a compulsion to speak, the degree to which the accused is deprived of his freedom, and the totality of the circumstances.⁸² After consideration of these factors, the court held that the confrontation in *McLean* was not an interrogation.

In adopting the case-by-case approach the supreme court appears to destine law enforcement officers to a position of uncertainty in confronting accused persons. Considering the egregious fact situation in *McLean*, however, it is clear that the court will defer to the officer's judgment in most instances. As pointed out by the dissent, it is difficult to say under the facts of this case that the officer did not intend the confrontation to be a tool to elicit information, or that defendant was not placed under mental compulsion to speak.⁸³ Further, the court in *McLean* assumed without discussion that if the *Miranda* decision was inapplicable, defendant's statements were voluntary and thus admissible.⁸⁴ Yet the majority of North Carolina courts holding defendants' statements voluntary, although made before being advised of *Miranda* rights, have dealt with situations involving more spontaneity than found in *McLean*, such as when the defendant voluntarily confronted the officer,⁸⁵ or was not yet the target of investigation,⁸⁶ or was confronted with evidence against him before probable cause to arrest was

found include *Rosher v. State*, 319 So. 2d 150 (Fla. Dist. Ct. App. 1975) (confrontation with codefendant held not interrogation); *Combs v. Commonwealth*, 438 S.W.2d 82 (Ky. 1969) (officer may read ballistics report to accused); *Howell v. State*, 5 Md. App. 337, 247 A.2d 291 (1968) (reading defendant a statement made by codefendant found acceptable).

Cases that reveal less hesitancy in finding interrogation include *Brewer v. Williams*, 430 U.S. 387 (1977) (officer's declaratory statements to accused, calculated to elicit an emotional response, held interrogation); *Commonwealth v. Mercier*, 451 Pa. 211, 302 A.2d 337 (1973) (reading statement by codefendant to defendant held interrogation).

81. 294 N.C. at 629, 242 S.E.2d 818. This is the approach used in *United States v. Akin*, 435 F.2d 1011 (5th Cir. 1970); *United States v. Charles*, 371 F. Supp. 204 (E.D.N.Y. 1973).

82. 294 N.C. at 628-30, 242 S.E.2d at 818. These are the factors that appeared to influence the court's decision.

83. *Id.* at 635-37, 242 S.E.2d at 821-22 (Exum, J., dissenting).

84. *Id.* at 629, 242 S.E.2d at 818.

85. *See State v. Bell*, 279 N.C. 173, 181 S.E.2d 461 (1971) (defendant voluntarily went to police headquarters to tell her side of story); *State v. Harrelson*, 265 N.C. 589, 144 S.E.2d 650 (1965) (defendant telephoned police department to say he was driver in hit-and-run accident).

86. *See State v. Pruitt*, 286 N.C. 442, 212 S.E.2d 92 (1975) (officer conducting on the scene investigation of a murder asked defendant some questions; defendant's subsequent answers held voluntary since defendant was not yet under suspicion); *State v. Chappell*, 24 N.C. App. 656, 211 S.E.2d 828 (1975) (also dealing with on the scene investigation).

established.⁸⁷ In no case did the officer have an unexecuted arrest warrant in his pocket.⁸⁸

The *McLean* decision is the first in North Carolina to recognize expressly that conduct, even though nonverbal, may be defined as interrogation although no questions as such were asked.⁸⁹ This holding is consistent with recent decisions of the United States Supreme Court⁹⁰ and several state courts⁹¹ that it is implicit in *Miranda* that interrogation consists of more than a question and answer format. The strength of the *McLean* court's finding is, however, diminished by the facts of the case. Clearly the court will be willing to find an interrogation only under the most egregious circumstances. One is left to wonder how long the officer could have sat in silence before the line into interrogation would have been crossed. The unfortunate result of the court's decision is to reward officers for circumventing the *Miranda* requirements by devising methods to elicit information that fall short of the definition of interrogation.⁹²

Once a court decides that evidence was obtained in a method pro-

87. See *State v. McCloud*, 276 N.C. 518, 173 S.E.2d 753 (1970) (confronted defendant with stolen coins seized from his room; subsequent confession held voluntary); *State v. Hines*, 266 N.C. 1, 145 S.E.2d 363 (1965) (statement by officer to defendant that others had confessed; defendant's subsequent confession held voluntary).

88. In a North Carolina Court of Appeals decision this year, *State v. Morton*, 36 N.C. App. 516, 244 S.E.2d 452 (1978), the court endorsed a liberal view of that degree of voluntariness legally necessary in a statement made after defendant has been advised of his *Miranda* rights. During the investigation of an armed robbery in *Morton*, officers read defendant his *Miranda* rights, then confronted him with three friends who were all crying and begging defendant to confess. Defendant eventually confessed and the court found this confession freely and voluntarily made, without coercive influence.

89. 294 N.C. at 630, 242 S.E.2d at 818. This finding dispels the notion in a previous court of appeals decision that an officer's handing defendant a hat, in an attempt to determine ownership, could not be interrogation because the defendant had not been asked a question. *State v. Burton*, 22 N.C. App. 559, 207 S.E.2d 344, cert. denied, 286 N.C. 212, 209 S.E.2d 316 (1974). In *Burton* the officer handed defendant a cap found at the scene of the crime and defendant accepted it, saying thank you. Defendant's actions and statements were held admissible.

90. See *Brewer v. Williams*, 430 U.S. 387 (1977). In *Brewer* the officer told defendant to think about certain statements the officer was going to make. He then made a speech clearly designed to elicit an emotional response. Although the officer told defendant he should not answer, the Supreme Court held defendant's subsequent statements barred as the result of an interrogation in which defendant had not waived his right to counsel.

91. See *State v. Godfrey*, 131 N.J. Super. 168, 178, 329 A.2d 75, 80 (1974) (confronting defendant with polygraph test results held interrogation); cases cited note 80 *supra*.

92. 294 N.C. at 635-37, 242 S.E.2d at 821-22 (Exum, J., dissenting). The trend in North Carolina courts toward less restriction on law enforcement activity is also evident in cases dealing with the sufficiency of an accused's waiver of his constitutional rights. An example is *State v. Smith*, 294 N.C. 365, 241 S.E.2d 674 (1978), in which the supreme court refused to follow the rule in other jurisdictions that a defendant in custody who is represented by counsel may not waive his constitutional rights in counsel's absence. See also *State v. Johnson*, 35 N.C. App. 729, 242 S.E.2d 517, cert. denied, 295 N.C. 263, 245 S.E.2d 779 (1978) (in absence of conflicting evidence, court may infer waiver of rights from surrounding circumstances).

hibited by the *Miranda* decision, the evidence is not necessarily inadmissible for all purposes, despite dictum in *Miranda* to the contrary.⁹³ The United States Supreme Court held in *Harris v. New York*⁹⁴ that *Miranda*-barred evidence can be introduced for impeachment purposes, provided the evidence satisfies legal standards of trustworthiness.⁹⁵ The court of appeals in *State v. Byrd*⁹⁶ further clarified the North Carolina position on when the legal standards of trustworthiness are satisfied.

Defendant in *Byrd* was told he was suspected of committing incest, read his *Miranda* rights, and then subjected to an in-custody interrogation. When officers learned that defendant could not read or write, his constitutional rights were explained to him and he signed a written waiver. During the ensuing interrogation defendant made several inculpatory statements.⁹⁷ There was some evidence that an officer shouted at defendant during the interrogation and made other threatening gestures.⁹⁸ The trial court found that because defendant had limited mental capacity he did not fully understand his right to counsel and had not effectively waived this right. The inculpatory statements were barred as substantive evidence by the trial court, but admitted for purposes of impeachment.⁹⁹

The court of appeals reversed, holding that the statements did not meet the legal standards of trustworthiness as mandated by *Harris*. The court found that the trustworthiness test is satisfied only when the

93. The Court in *Miranda* stated:

The privilege against self-incrimination protects the individual from being compelled to incriminate himself in any manner. . . . [S]tatements merely intended to be exculpatory by the defendant are often used to impeach his testimony at trial These statements are incriminating in any meaningful sense of the word and may not be used without the full warnings and effective waiver required for any other statement.

384 U.S. at 476-77.

94. 401 U.S. 222 (1971).

95. *Id.* at 224. The court stated: "It does not follow from *Miranda* that evidence inadmissible against an accused in the prosecution's case in chief is barred for all purposes, provided of course that the trustworthiness of the evidence satisfies legal standards." See generally Howard, *State Courts and Constitutional Rights in the Day of the Burger Court*, 62 VA. L. REV. 873 (1976); Note, 8 WAKE FOREST L. REV. 276 (1972).

96. 35 N.C. App. 42, 240 S.E.2d 494 (1978).

97. When officers asked defendant if he had committed incest, defendant replied, "I guess there is no . . . reason I do a lot of things I know is wrong I reckon I will lose everything." *Id.* at 44, 240 S.E.2d at 495.

98. *Id.* at 43, 240 S.E.2d at 495.

99. The trial court's finding that defendant's waiver was not effective to waive his rights to counsel, but did effectively waive his right to remain silent, reflects the lower burden the state must meet to prove an effective waiver of the right to remain silent. The double standard for proving waiver was established in *State v. Swift*, 290 N.C. 383, 226 S.E.2d 652 (1976). See *Survey of Developments in North Carolina Law, 1976*, 55 N.C.L. REV. 895, 992-98 (1977).

statement was voluntarily made with full understanding of the constitutional rights being waived.¹⁰⁰ In *Byrd* there was conflicting evidence concerning the voluntariness of defendant's statements, but the trial court held the statements admissible for impeachment without a specific determination of their voluntariness. The court of appeals held that when there is conflicting evidence on voluntariness, a judge is required to make a specific determination of voluntariness before the evidence may be admitted for impeachment. The court also stated that even when there is no conflicting evidence on voluntariness, it would still be the better practice for a judge to make a specific finding on voluntariness.¹⁰¹ The case was remanded for such a determination by the trial judge.

The *Byrd* decision is significant not only for its definition of trustworthiness, but also for its interpretation of prior North Carolina cases. In *State v. Bryant*,¹⁰² the North Carolina Supreme Court found a *Miranda*-barred statement admissible for impeachment purposes without any discussion of its voluntariness. The court's only mention of the issue was a reference to defendant's complaint that the trial court had not specifically found the statements voluntary.¹⁰³ The court's lack of discussion led to uncertainty about whether any standard of voluntariness need be met before the statement would be admitted. Although the United States Supreme Court denied a writ of certiorari to hear the *Bryant* case, two justices dissented from the denial in recognition of the uncertainty in the *Bryant* holding.¹⁰⁴ They argued that defendant had put the question of voluntariness in issue, and by not addressing this issue the North Carolina court had gone a step beyond the *Harris* decision to allow the introduction of illegally obtained statements without any requirement of voluntariness.¹⁰⁵

The court in *Byrd* adopted a restrictive construction of the *Bryant* holding, interpreting *Bryant* as authority for the proposition that when there is no evidence of involuntariness, then the *Miranda*-barred statements are deemed voluntary and no specific determination by the trial

100. 35 N.C. App. at 45, 240 S.E.2d at 496.

101. *Id.* at 45-46, 240 S.E.2d at 496. This holding is consistent with implications in *Oregon v. Hass*, 420 U.S. 714 (1975).

102. 280 N.C. 551, 187 S.E.2d 111, *cert. denied*, 409 U.S. 995 (1972). The statement in *Bryant* was also *Miranda*-barred due to an ineffective waiver of counsel. *Id.* at 554-55, 187 S.E.2d at 113.

103. *Id.* at 554, 187 S.E.2d at 113.

104. 409 U.S. 995, 996 (1972) (Douglas and Brennan, JJ., dissenting).

105. *Id.* at 996-97.

judge need be made.¹⁰⁶ The *Byrd* court has thus diminished the possible impact of the *Bryant* decision and established that the requirement of voluntariness must be satisfied before a *Miranda*-barred statement can be admitted for impeachment purposes.

C. Right to Counsel

In *State v. Sanders*,¹⁰⁷ the North Carolina Supreme Court reversed a lower court decision¹⁰⁸ placing on the defendant the burden of raising again the issue of his indigency when he has been found not to be indigent earlier in the same proceeding. The court held that G.S. 15A-942¹⁰⁹ required the trial judge to inquire newly into the indigency of defendant when he appeared at arraignment without counsel after trying twice unsuccessfully to establish his indigency. The court further held that failure to so inquire entitled defendant to a new trial.¹¹⁰

In *Sanders*, defendant's first affidavit asserted that he was regularly employed with a weekly salary of \$100, owned a car and a house, and owed \$728. His second petition, filed over a month after the first and over two months before his trial, stated that he had become unemployed, was making payments of \$40 per month on his car, and owed \$500 to \$600 in monthly payments on his home. After the denial of his second petition, defendant twice appeared *pro se* at trials that were declared mistrials for defects in the indictments,¹¹¹ and then appeared *pro se* at the arraignment and trial that resulted in his conviction for receipt of stolen goods.¹¹²

The result in this case turned on the interpretation given G.S. 15A-942, which provides: "If the defendant appears at the arraignment without counsel, the court must inform the defendant of his right to counsel, must accord the defendant opportunity to exercise that right, and must take any action necessary to effectuate that right."¹¹³ The

106. 35 N.C. App. at 45, 240 S.E.2d at 496.

107. 294 N.C. 337, 240 S.E.2d 788 (1978).

108. 34 N.C. App. 59, 237 S.E.2d 475 (1977), *rev'd*, 294 N.C. 337, 240 S.E.2d 788 (1978).

109. N.C. GEN. STAT. § 15A-942 (1978), *quoted in text* accompanying note 113 *infra*.

110. 294 N.C. at 343, 240 S.E.2d at 791. The court based its decision on *State v. Morris*, 275 N.C. 50, 165 S.E.2d 245 (1968). That case involved interpretation of a statute whose requirements were essentially the same as the statute here in question. 294 N.C. at 345-46, 240 S.E.2d at 792-93.

111. 294 N.C. at 338-39, 240 S.E.2d at 788-89. The first indictment failed to charge defendant with receipt of stolen goods, the crime for which he was to be tried. The second indictment contained a count of receiving stolen goods, but charged the owner of the goods, and not defendant, with that crime. Both mistrials were declared on the court's own motion. *Id.* at 339, 240 S.E.2d at 789.

112. *Id.* at 340, 240 S.E.2d at 789.

113. N.C. GEN. STAT. § 15A-942 (1978).

court of appeals interpreted the statute to mean that, by the time of arraignment, a defendant must have been informed of his right to appointed counsel if indigent and must have had an opportunity to exercise that right;¹¹⁴ the court thus viewed the provision as merely a fail-safe device to ensure defendant's knowledge of his right. Thus, it determined that failure to comply with the provision when defendant knew of and had attempted to exercise his right was not prejudicial error.¹¹⁵

The supreme court, however, interpreted the statute as placing an affirmative duty on the trial judge to inquire into the defendant's indigency "irrespective of any request by defendant"¹¹⁶ in order to make defendant aware that he could exercise his rights at that point in the proceedings.¹¹⁷ The court noted that the layman defendant has no way of knowing that the issue of indigency can be redetermined at the time of his arraignment and that when, as in this case, defendant's application for appointed counsel has twice been denied, defendant likely concluded a third application would be useless.¹¹⁸

The court found that absence of counsel prejudiced defendant in the presentation of his case because defendant lacked skills and expertise necessary to cross-examine effectively prosecution witnesses, to make objections, and to use jury argument.¹¹⁹ These factors are likely to appear in every case in which a layman is conducting his own defense, making prejudice almost a foregone conclusion whenever the trial judge has failed to inform defendant of his right to counsel.

The interpretation given G.S. 15A-942 in *Sanders* is a sound one that will serve to ensure compliance with the constitutional requirement¹²⁰ that waiver of counsel be knowing and voluntary.¹²¹ Had the interpretation of the court of appeals been accepted, the statutory pro-

114. 34 N.C. App. 59, 61-62, 237 S.E.2d 475, 476-77.

115. *Id.*

116. 294 N.C. at 344, 240 S.E.2d at 792.

117. *Id.*

118. *Id.*

119. *Id.* at 346-47, 240 S.E.2d at 793-94. The court rejected the State's contention that failure to comply with the statute, if error, was harmless because defendant was not indigent at the time of trial. *Id.* at 344, 240 S.E.2d at 792. The State supported this claim by pointing out that defendant was represented by private counsel on appeal and had been able to post a \$300 appeal bond and a \$5,000 appearance bond after his conviction. 34 N.C. App. 59, 62, 237 S.E.2d 475, 476. The supreme court found these facts to be irrelevant: "That defendant is now represented by counsel and is out under a premium-paid bond discloses only that a nonindigent has expended money in defendant's behalf. It is not proof that defendant himself was not indigent [on the date of his trial]." 294 N.C. at 344, 240 S.E.2d at 792.

120. Arguably, this was the legislative intent in enacting the statute. See *State v. Morris*, 275 N.C. 50, 56-57, 165 S.E.2d 245, 249 (1968).

121. *Miranda v. Arizona*, 384 U.S. 436, 475-76 (1966).

vision would have been meaningless and of no protection to indigent defendants. By its interpretation in *Sanders*, the court has set out a clear standard of the extent of the duty of the State to inform defendant of his right to counsel, which should be simple for trial judges to follow.

D. *Effective Assistance of Counsel*

In *United States v. Evans*,¹²² the United States Court of Appeals for the Fourth Circuit reversed defendant's conviction of bank robbery and remanded his case for a new trial because of the trial judge's abuse of discretion in denying a motion for continuance on the ground of late appointment of counsel. In reviewing the denial of a continuance the court applied the same criterion it used in *United States v. Gaither*¹²³—the actual performance of counsel during trial.¹²⁴ In *Evans*, defendant had been found to be ineligible for appointed counsel at arraignment, but apparently had not been informed of his right to reassert his indigency.¹²⁵ Five days prior to trial, the prosecutor obtained an ex parte order for increased bail on the ground that defendant was unlikely to appear because he had not prepared a defense; defendant was then jailed. The next day, a Friday, defendant executed a second affidavit of indigency and counsel was immediately appointed. After conferring with defendant over the weekend, counsel moved for a continuance on Monday. The motion was denied and the trial began on Tuesday. Having had insufficient time to prepare the case and interview witnesses, defendant Whitehead's attorney deferred to codefendant's counsel. Because the position of the defendants was antagonistic, this deferral proved damaging to Whitehead's defense and resulted in a failure to provide effective assistance of counsel.¹²⁶ The court of appeals held that because the denial of a continuance resulted in impaired performance of counsel at trial,¹²⁷ it constituted an abuse of discretion.¹²⁸

This standard will not be an easy one for trial judges to apply be-

122. 569 F.2d 209 (4th Cir.), *cert. denied*, 435 U.S. 975 (1978).

123. 527 F.2d 456 (4th Cir. 1975), *cert. denied*, 425 U.S. 952 (1976).

124. *Id.* at 457-58.

125. In addition, defendant was warned by the United States Attorney to retain private counsel or prepare to defend himself. 569 F.2d at 211.

126. *Id.*

127. The court seemed to view the question in terms of whether the result of the denial was to deprive defendant of effective assistance of counsel. *Id.*; see *United States v. Gaither*, 527 F.2d at 457-58.

128. The court recognized that denial of a continuance would not have been an abuse of discretion had counsel's difficulties at trial been caused by defendant. 569 F.2d at 211.

cause it will require them to predict or anticipate the effects of a denial on the performance of defense counsel at trial. Although it is by no means a clear standard to use in making the decision, it should serve to impress upon the trial judge the importance and probable effects of his decision whether to grant a continuance. Should he deny that motion, the standard of review employed on appeal will be a constitutional one, that of effective assistance of counsel.¹²⁹ By adopting this test as the yardstick for finding an abuse of discretion, the court has reemphasized that defendants have a right to an adequate time to prepare their defense.

E. Right to Speedy Trial

In *State v. McKoy*,¹³⁰ the North Carolina Supreme Court, over a strong dissent,¹³¹ reversed a unanimous court of appeals panel¹³² and held that a wilful delay by the prosecution in bringing a case to trial, absent any significant prejudice to defendant, was a violation of defendant's right to a speedy trial and required a dismissal of the charges. Defendant in *McKoy* was charged with second degree murder in a shooting death that occurred in October 1974. He was arrested in November of the same year.¹³³ The grand jury indicted him in February 1975. Trial was initially set for June 2, 1975, but the State was granted a continuance. Defendant's counsel frequently made oral requests of the prosecuting attorney between June 1975 and January 1976 for an early trial date but was told that because defendant was in prison where he belonged there was no need to try him. On January 22, 1976, defendant moved to dismiss for violation of his right to speedy trial. This motion was denied, and the trial judge ordered trial calendared by the May 1976 session.¹³⁴ The case was delayed for various reasons until August 9, 1976. At that time, defendant again moved to dismiss, claiming as prejudice the unavailability of a material defense witness. This

129. The test for effectiveness of counsel is whether the performance was within the range of competence normally expected in criminal trials. *Marzullo v. Maryland*, 561 F.2d 540 (4th Cir. 1977), *cert. denied*, 435 U.S. 1011 (1978). The standard was recently applied in a habeas corpus proceeding brought by a North Carolina prisoner although no constitutional violation was found. *See Fuller v. Luther*, 575 F.2d 1098 (4th Cir. 1978).

130. 294 N.C. 134, 240 S.E.2d 383 (1978).

131. *Id.* at 144, 240 S.E.2d at 390 (Moore, J., joined by Sharp, C.J., dissenting).

132. 33 N.C. App. 304, 235 S.E.2d 98 (1977), *rev'd*, 294 N.C. 134, 240 S.E.2d 383 (1978).

133. Upon his arrest, defendant's parole for a prior conviction of involuntary manslaughter was revoked and he was returned to Central Prison where he remained until trial. 294 N.C. at 136, 240 S.E.2d at 386.

134. The case was calendared for April 12, 1976, but was not called because of the unavailability of defense counsel. *Id.* at 137, 240 S.E.2d at 386.

motion was denied, and defendant was tried and convicted of voluntary manslaughter. The court of appeals rejected defendant's claim that the delay caused the loss of the witness and held that, in the absence of prejudice, defendant was entitled to no relief.¹³⁵

In reaching its decision, the supreme court applied the balancing test of *Barker v. Wingo*,¹³⁶ which takes into account the following factors: the length of the delay, the cause of the delay, waiver or demand of the right by the defendant, and prejudice to the defendant.¹³⁷ The court quickly found the twenty-two month delay sufficient to raise a constitutional issue,¹³⁸ and held that the repeated oral requests by defense counsel definitively established lack of waiver.¹³⁹

In evaluating the reason for the delay, the court divided the period into separate parts. It found no unreasonable delay for the periods prior to June 1975 and after April 1976.¹⁴⁰ The ten month intervening delay was established to be due to the wilful neglect of the prosecution in responding to defense counsel's oral demands.¹⁴¹ The *McKoy* decision is surprising because the court reversed the conviction in the face of its finding that any prejudice to defendant was minimal. The supreme court agreed with the court of appeals in rejecting defendant's claim of loss of a witness, stating that had she appeared and testified for defendant "it is highly improbable that the testimony . . . would have affected the result."¹⁴² Although the witness loss was the only prejudice claimed by defendant, it is arguable that other types of prejudice resulted.¹⁴³ When defendant was arrested for the crime in this case, his parole from a prior manslaughter conviction was revoked and he was returned to prison.¹⁴⁴ The pending charges resulted in his incarceration from the time of his arrest to the date of his trial. Furthermore, defendant was prejudiced by the anxiety caused by the unresolved charges.

135. See 33 N.C. App. 304, 235 S.E.2d 98 (1977).

136. 407 U.S. 514 (1972).

137. *Id.* at 530.

138. 294 N.C. at 141, 240 S.E.2d at 388.

139. *Id.* at 142, 240 S.E.2d at 389.

140. *Id.* at 141, 240 S.E.2d at 388-89.

141. *Id.* at 141-42, 240 S.E.2d at 389. It is arguable that the court defined wilful neglect as that which "could have been avoided by reasonable effort." *Id.*

142. 294 N.C. at 143, 240 S.E.2d at 389.

143. The United States Supreme Court has recognized three different types of prejudice, each to an interest that the speedy trial right protects: (1) pretrial incarceration, (2) anxiety of an accused over the unresolved charges, and (3) impairment of the defense. *Barker v. Wingo*, 407 U.S. at 532.

144. Defendant claimed that his parole was revoked because of his arrest but did not offer any proof to support his contention. See Defendant Appellant's Brief at 2, Brief for the State at 5.

Even though this prejudice may not be enough, by itself, to require reversal, its use here to augment the basis of the decision would have brought *McKoy* much closer to the long line of North Carolina cases granting relief only upon a showing of prejudice.¹⁴⁵

The court did not indicate any belief or possibility that defendant might have been innocent of the offense charged. On the contrary, the court doubted that there would have been a different result even had the absent defense witness appeared. Justice Moore, in dissent, echoed the sentiments of the court of appeals panel:¹⁴⁶ "I do not believe sufficient prejudice has been shown to justify the release of this twice-convicted killer."¹⁴⁷ Dismissal of charges in this voluntary manslaughter case, given defendant's prior manslaughter conviction, is an extreme remedy.

Because of the court's sole reliance on the wilful neglect of the prosecution and the extreme nature of the remedy, *McKoy* is best interpreted as a strong reminder to prosecutors of their duty to try defendants within a reasonable time and the possible dire consequences when that duty is not fulfilled.¹⁴⁸

F. Breathalyzer Test Administration

The North Carolina Court of Appeals decided two cases in 1978 that required interpretation of different statutory sections dealing with administration of the breathalyzer test. Both cases presented problems of statutory construction and matters of public policy.

In *State v. Jordan*,¹⁴⁹ the court was called upon to give further definition to the term "arresting officer" contained in G.S. 20-139.1(b).¹⁵⁰ The statute prohibits "the arresting officer or officers"¹⁵¹ from administering a breathalyzer test to a person the officer has arrested on suspicion of driving under the influence of intoxicating li-

145. See, e.g., *State v. Hill*, 287 N.C. 207, 214 S.E.2d 67 (1975); *State v. Brown*, 282 N.C. 117, 191 S.E.2d 659 (1972).

146. 33 N.C. App. 304, 308-09, 235 S.E.2d 98, 100 (1977). The court of appeals found that the unavailability of the witness was insufficient prejudice.

147. 294 N.C. at 146, 240 S.E.2d at 391 (dissenting opinion).

148. *McKoy* could be viewed as an exercise of the court's power of general supervision and control of proceedings in the lower state courts. The existence of this power was first declared in *State v. Crook*, 132 N.C. 1053, 44 S.E. 32 (1903). The United States Court of Appeals for the Fourth Circuit has recognized that prosecutorial misconduct may be proper grounds for use of its general supervisory power. *United States v. Neiswender*, No. 77-1642 (4th Cir., filed Jan. 9, 1979).

149. 35 N.C. App. 652, 242 S.E.2d 192 (1978).

150. N.C. GEN. STAT. § 20-139.1(b) (1978).

151. *Id.*

quor. In *Jordan*, defendant was arrested for driving under the influence by Trooper Banks. After taking a breathalyzer test, which was administered by another officer, defendant secured his release on bail. Approximately twenty minutes later he was arrested by Officer Martin on a similar charge. Defendant was taken to the police station where he took another breathalyzer test. This second test was administered by Banks, the officer who had arrested defendant earlier that evening for driving under the influence.¹⁵²

Based on the second arrest, defendant was convicted of operating a motor vehicle while under the influence. Over defendant's objection that Banks should be considered an "arresting officer" and therefore prohibited from testifying under G.S. 20-139.1(b), Trooper Banks was allowed to testify about results of the breathalyzer test he administered. On appeal defendant argued that, since the purpose of the statute is to ensure fairness and impartiality in administration of the test,¹⁵³ the strong possibility that Banks had a preconceived notion that the test would disclose a high alcoholic content was enough to make his administration of the test illegal and to disqualify him from testifying.¹⁵⁴

The court rejected defendant's argument that the policy of the statute required the exclusion of Banks' testimony. The court stated that the limitation on the arresting officer's ability to administer the test grew out of recognition that the judgment of the officer who arrests the defendant or the judgment of the officer who selects the defendant for arrest might well be in issue at trial.¹⁵⁵ Absent the statutory limitation, an arresting or selecting officer who also administered the test might appear to have an interest in the outcome of the test because its outcome confirms or refutes the soundness of his earlier judgment. Consequently, the court stated that the interest of fairness demands that arresting or selecting officers be prohibited from administering the test. Although the court focused on only two possible relationships that an officer might have to a person who is arrested, it is clear that the court would disqualify any officer from administering the test who was so

152. 35 N.C. App. at 653, 242 S.E.2d at 193.

153. *State v. Stauffer*, 266 N.C. 358, 359, 145 S.E.2d 917, 918 (1966) ("The purpose of this limitation in the statute is to assure that the test will be fairly and impartially made.").

154. 35 N.C. App. at 653, 242 S.E.2d at 193.

155. The peculiar situation of the officer who selected the defendant for arrest arose in *State v. Stauffer*, 266 N.C. 358, 145 S.E.2d 917 (1966). In that case the officer who administered the test was the person who originally observed and stopped the defendant. Another officer, who had responded to a radio call, made the actual arrest although the first officer remained at the scene of the arrest to assist. The court held that the first officer's assistance made him an "arresting officer" within the meaning of the statute.

causally connected to a particular arrest that his impartiality might be questioned.¹⁵⁶ In *Jordan*, however, it was uncontested that Trooper Banks had absolutely nothing to do with causing defendant's second arrest. The court held that Banks' earlier arrest and opportunity for prior observation of the defendant, which may indeed have led to preconceived notions about what the test would disclose, did not bring him within the disqualification set out in the language or the policy of the statute.

In the other case dealing with aspects of North Carolina's breathalyzer law, *Price v. North Carolina Department of Motor Vehicles*,¹⁵⁷ the court of appeals considered G.S. 20-16.2(a)(4),¹⁵⁸ which states that, upon arrest and a request to submit to a breathalyzer test, the accused "has the right to call an attorney and select a witness to view for him the testing procedures; but that the test shall not be delayed for *this purpose* for a period in excess of thirty minutes from the time he is notified of his rights."¹⁵⁹ The court noted that the statute is ambiguous because it is not clear to which of the two rights contained in the first clause the limitation in the second clause applies.¹⁶⁰

In *Price*, petitioner was arrested for driving under the influence of intoxicating liquor, taken to the police station and requested to submit to the breathalyzer test. Petitioner telephoned his attorney twice and

156. The court's conclusion that the statute was enacted to prevent test administration only by officers who were in some way causally connected with the arrest is supported by prior case law. In *State v. Dail*, 25 N.C. App. 552, 214 S.E.2d 219 (1975), the court rejected defendant's claim that an officer who stopped at the scene after defendant's arrest solely to remove defendant's car from the highway and who later administered the test was an "arresting officer." In *State v. Green*, 27 N.C. App. 491, 219 S.E.2d 529 (1975), the court held that an officer who had observed defendant in an inebriated state 40 minutes prior to the time he administered the test to him was not an "arresting officer." In *State v. Stauffer*, 266 N.C. 358, 145 S.E.2d 917 (1966), however, the court's finding that the officer who administered the test was at the scene of the arrest for the purpose of assisting in the arrest was crucial to its determination that the officer *was* an "arresting officer." In *Dail* and *Green*, the officers were not involved in making the arrest, although they had some contact with defendant prior to test administration; in *Stauffer*, the officer who administered the test was the person who actually initiated the arrest procedure.

157. 36 N.C. App. 698, 245 S.E.2d 518, *cert. denied*, 295 N.C. 551, 248 S.E.2d 728 (1978).

158. N.C. GEN. STAT. § 20-16.2(a)(4) (1978).

159. *Id.* (emphasis added).

160. 36 N.C. App. at 701, 245 S.E.2d at 520. The court stated that the statute could be interpreted any of three ways: 1) that the legislature used the wrong language and really meant to say "these purposes"; 2) that the singular phrase "this purpose" was intended to apply to the right to call an attorney; or 3) that the phrase "this purpose" refers to the right to select a witness. *Id.* at 701-02, 245 S.E.2d at 520-21.

This is the first case in which the ambiguity has been at issue. North Carolina courts have never defined which right the second clause limits. The courts, however, have generally assumed that the limitation applies either to the right to "select a witness" or to both rights. See *State v. Buckner*, 34 N.C. App. 447, 238 S.E.2d 635 (1977).

refused to take the test until his attorney arrived at the station. After his attorney arrived, and forty-one minutes after being requested to submit to the test, petitioner indicated his willingness to take the test. The test operator, however, refused to administer it because of the delay. The Division of Motor Vehicles subsequently revoked petitioner's operators license because of his refusal to submit to administration of the test within thirty minutes after being requested to do so.¹⁶¹ Petitioner challenged the finding that he violated the statute and claimed that his driving privilege was improperly revoked. The court of appeals affirmed the revocation order.

Petitioner advanced two major arguments for the proposition that he did not violate G.S. 20-16.2.¹⁶² Both depended upon a rather strained interpretation of the statute.¹⁶³ He first argued that the limiting phrase "this purpose" in the statute refers to the right to "call an attorney" and not to the right to "select a witness." Thus, petitioner asserted that the statute allows a person only thirty minutes to call an attorney, but that one has an undefined amount of reasonable time (in this case at least forty-one minutes) to select a witness and secure his attendance. Petitioner argued that his refusal to take the test before his attorney arrived was not a violation of the statute because he was simply exercising his right to a reasonable time to secure a witness.¹⁶⁴

In his second argument petitioner asserted a right to a reasonable time to communicate *in person* with counsel before being forced to take the test. Petitioner claimed that, because the statute contains an arbitrary thirty minute time limit on the right to call an attorney, the statute conflicted with and impermissibly restricted his rights under G.S. 15A-501(5),¹⁶⁵ which provides that a person, upon arrest, has a "reasonable time" to "communicate with counsel." Petitioner argued that this lan-

161. On the day of his arrest, February 28, 1976, petitioner pleaded guilty to the charge of operating a motor vehicle on the highway while under the influence of intoxicating liquor. The Division of Motor Vehicles, acting under the authority of N.C. GEN. STAT. § 20-16.2 (1978), revoked his driving privilege on March 21, 1976. The revocation order was affirmed by the superior court on March 24, 1977.

162. N.C. GEN. STAT. § 20-16.2 (1978).

163. Petitioner also advanced constitutional arguments that were apparently based on the theory that he was entitled to a sixth amendment right to presence of counsel at the administration of the breathalyzer test. Citing *Schmerber v. California*, 384 U.S. 757 (1966), *State v. Syker*, 285 N.C. 202, 203 S.E.2d 849 (1974), and decisions from other states, the court summarily rejected these constitutional arguments. The court stated that "there is no right to the presence of counsel at the administration of breathalyzer tests or other similar tests." 36 N.C. App. at 703, 245 S.E.2d at 522.

164. 36 N.C. App. at 701, 245 S.E.2d at 520.

165. N.C. GEN. STAT. § 15A-501(5) (1978).

guage in G.S. 15A-501(5) overrode the limitation in G.S. 20-16.2 and protected his right to refuse to take the test until he had a reasonable time to communicate in person with counsel.¹⁶⁶

The court acknowledged the ambiguity in G.S. 20-16.2 and the potential conflict between that statute and G.S. 15A-501(5),¹⁶⁷ but disagreed with petitioner's interpretation of G.S. 20-16.2. The court examined G.S. 20-16.2 in light of public policy and according to traditional rules governing statutory construction, and concluded that the thirty minute limitation referred only to the right to select a witness and secure his attendance at the test administration and *not* to the right to call an attorney.¹⁶⁸ Petitioner, who desired his lawyer to function as a witness, thus violated the statute when he attempted to delay the administration of the test longer than thirty minutes in exercise of his right to select a witness.

The court's interpretation of G.S. 20-16.2 eliminated any possible conflict between that statute and G.S. 15A-501(5). Because the thirty minute time limitation applies only to the right to secure a witness, the court held that the "reasonable time" time limitation contained in G.S. 15A-501(5) applies to the right to call an attorney in G.S. 20-16.2. Because petitioner was allowed to contact his lawyer on the telephone, the court held that he was afforded reasonable time to communicate with counsel and that his right to call an attorney was satisfied. The court rejected petitioner's argument that G.S. 15A-501(5) gave him a right to communicate with counsel *in person* before the test could be administered.¹⁶⁹

Because petitioner in *Price* did communicate with counsel, the court left open the question of what is a reasonable time for calling an attorney when the accused is seeking to delay administration of the

166. 36 N.C. App. at 701, 245 S.E.2d at 520.

167. *Id.*

168. The court applied the following rules of statutory construction: 1) a statute imposing a penalty must be strictly construed; and 2) statutes *in pari materia* should be construed together. Strict construction of the statute would apply the singular phrase "this purpose" to the phrase closest to it, the right to "select a witness." Interpreting the statute so that the limitation would apply only to the second right would harmonize statutes *in pari materia* because the time limitation contained in § 15A-501(5), the statute that guarantees the right to communicate with counsel generally, would then apply to the first right to "call an attorney." *Id.* at 702, 245 S.E.2d at 521.

The court insisted that its interpretation of the statute was supported by "common sense and sound public policy." *Id.* at 703, 245 S.E.2d at 521. The court stated that exercise of the right to call an attorney generally requires only a few minutes so that there is no great need for a time limitation on this right. A time limitation on the right to select a witness and secure his attendance was necessary, however, because exercise of this right might entail a lengthy delay that could render the test ineffective.

169. *Id.* at 704, 245 S.E.2d at 522.

breathalyzer test. Given the need for relatively quick administration of the test and recognizing that calling an attorney generally takes only a few minutes, it would seem that very special circumstances would be required before a period of thirty minutes would be deemed unreasonable.

In both *Jordan* and *Price* the court rejected expansive interpretations of rights guaranteed by statute to persons to whom the breathalyzer test is administered. Although neither case presented a very convincing argument for extending protection, it is clear that the court's refusal to expand protections was influenced by the public policy considerations in favor of quick and efficient administration of the breathalyzer test.

G. Arraignment Rights

In *State v. Davis*,¹⁷⁰ the North Carolina Court of Appeals interpreted G.S. 15A-943(b),¹⁷¹ a provision of the Speedy Trial Act giving the defendant the right not to be tried within one week of his arraignment. In *Davis*, defendant's trial on drug charges began on the same day as his arraignment. Before trial, defendants¹⁷² moved for a continuance on the ground of inability to locate an essential defense witness. This motion was denied. Defendant did not enter a general objection, nor did he specifically assert his right under the statute. The court held that failure to assert this right resulted in waiver.

The court's decision in *Davis* was foreshadowed by the North Carolina Supreme Court's decision in *State v. Shook*.¹⁷³ In that case, the court held that the provision gave defendant a statutory right not to be tried in the week of his arraignment and noted that, like other such rights, it could be waived. Under North Carolina law, a defendant is deemed to waive the benefit of a statutory right by "express consent, failure to assert it in apt time, or by conduct inconsistent with a purpose to insist upon it."¹⁷⁴ The court of appeals followed this line of reason-

170. 38 N.C. App. 672, 248 S.E.2d 883 (1978).

171. N.C. GEN. STAT. § 15A-943(b) (1978). The statute provides: "When a defendant pleads not guilty at an arraignment required by subsection (a), he may not be tried without his consent in the week in which he is arraigned." *Id.* § 15A-943(a) provides for scheduling of arraignments in counties where there are 20 or more weeks of trial sessions scheduled for criminal cases in the superior court.

172. *Davis*' trial was consolidated with that of a codefendant who had been arraigned over two months earlier. Thus, only *Davis*' statutory right was in question.

173. 293 N.C. 315, 237 S.E.2d 843 (1977).

174. *State v. Gaiten*, 277 N.C. 236, 239, 176 S.E.2d 778, 781 (1970); see *State v. Young*, 291 N.C. 562, 567, 231 S.E.2d 577, 580 (1977).

ing, focusing on the statutory nature of the right, and held that failure to object specifically on the ground of this provision resulted in waiver.

In finding a waiver in *Davis*, the court ignored the language of G.S. 15A-943(b). The statute provides that a defendant may not be denied his right "without his *consent*."¹⁷⁵ Thus, the question should have been what constitutes "consent." The word should have been interpreted in light of the legislative purpose of the statute, which is to ensure the State and the defendant an adequate time to prepare for trial.¹⁷⁶ It would therefore be reasonable to conclude that any motion for continuance relating to time needed to prepare for trial would be sufficient to manifest nonconsent or nonwaiver. This conclusion is buttressed by the supreme court's holding in *Shook* that the statute is not merely directory, because it "'promotes justice'" and "'affects the public interest.'"¹⁷⁷ In order for the statute to achieve its purpose, an interpretation of consent much narrower and more specific than that given by the court in *Davis* is required.

H. Amendment of Indictments

G.S. 15A-923(e)¹⁷⁸ states that "[a] bill of indictment may not be amended."¹⁷⁹ In *State v. Carrington*,¹⁸⁰ the North Carolina Court of Appeals, for the first time, defined the word "amendment" as used in G.S. 15A-923(e) to mean "any change in the indictment which would substantially alter the charge set forth in the indictment."¹⁸¹ Thus, the court, in effect, rewrote the statute to permit amendment of indictments when the amendment does not substantially alter the original charge. This interpretation appears to be an attempt to harmonize the statute with prior, more liberal North Carolina case law on this subject.

In *Carrington*, defendant was indicted on the charges of accessory after the fact to a murder and armed robbery committed by an alleged codefendant and "one (other) black male, name unknown."¹⁸² The co-

175. N.C. GEN. STAT. § 15A-943(b) (1978) (emphasis added).

176. *State v. Shook*, 293 N.C. at 318, 237 S.E.2d at 846.

177. *Id.* at 319, 237 S.E.2d at 846 (quoting *Davis v. Board of Educ.*, 186 N.C. 227, 231, 119 S.E. 372, 374 (1923)).

178. N.C. GEN. STAT. § 15A-923(e) (1978).

179. *Id.*

180. 35 N.C. App. 53, 240 S.E.2d 475, *cert. denied*, 294 N.C. 737, 244 S.E.2d 155 (1978).

181. *Id.* at 57, 240 S.E.2d at 478.

182. *Id.* Two indictments were returned: one charging accessory to murder and the other charging accessory to armed robbery. Part of the indictment charging defendant with accessory after the fact of murder read:

The jurors for the State upon their oath present that on or about the 19th day of Febru-

defendant was acquitted on all charges prior to defendant's trial. At defendant's trial his motion to dismiss the indictments on the ground that they charged him with being an accessory to crimes committed by a person who had been acquitted was denied. Instead, the court amended the indictments to excise mention of the alleged codefendant and proceeded to trial on the balance of the indictments, which charged defendant with accessory after the fact to crimes committed by an unknown male. Defendant was found guilty at trial and argued on appeal that the court's action in amending the indictments was error under G.S. 15A-923(e).¹⁸³ The court of appeals rejected defendant's argument because it found, under its new definition, that the amendments did not substantially alter the charges set forth in the indictment.¹⁸⁴

The strictest common law rule prohibited the making of any amendment to an indictment. Some courts held, however, that amendment of an indictment was permissible with the consent of the grand jury that presented it.¹⁸⁵ In North Carolina, the approach that permitted amendment only with grand jury consent seems to have been followed in only one early case.¹⁸⁶ Despite references to this rule in some early twentieth century cases,¹⁸⁷ the modern rule that emerged in North Carolina held that courts had the power to amend indictments as to

ary, 1976, in Durham County Obie Carrington, Jr. unlawfully and wilfully did feloniously give aid and assistance to (Arthur Junior Parrish and) one (other) black male, name unknown, who had unlawfully, wilfully, and feloniously killed and murdered Otis Jackson Riggsbee, Jr. . . . At the time of the giving of aid and assistance, the defendant knew that (Arthur Junior Parrish and) the aforesaid (other) black male, name unknown, had committed the felony of Murder

Id.

183. Defendant argued that the amendments violated his due process rights on three separate but related grounds: 1) that any amendment was error under § 15A-923(e); 2) that the amendments that were made improperly expanded the charges against him; and 3) that the indictments, as amended, were not specific enough to allow him to plead any conviction in bar of future prosecutions. *Id.* at 57-58, 240 S.E.2d at 478. The court rejected defendant's third argument because it found, upon examination of the indictments, that the offenses charged were clear and that a conviction would bar future prosecutions. Defendant's second argument was rejected because the court held that the amendments did not expand the charge and, in fact, made the State's case harder to prove. The court's treatment of the first argument is discussed in the text. The court did not consider whether the solution it adopted raised any due process objections.

184. The amendments did not alter in any way the offenses that were charged; as the court pointed out, the State was still required to prove all the elements of the offenses originally charged.

185. See 41 AM. JUR. 2d *Indictments and Informations* §§ 172, 174 (1968); 42 C.J.S. *Indictments and Informations* § 230 (1944).

186. *State v. Sexton*, 10 N.C. (3 Hawks) 184 (1824).

187. See *State v. Dowd*, 201 N.C. 714, 161 S.E. 205 (1931); *State v. Corpening*, 191 N.C. 751, 133 S.E. 14 (1926). In these cases no amendment was made at trial so the court did not have to pass on the point; the references were made in dictum.

matters of form but not as to matters of substance.¹⁸⁸ While North Carolina courts have not given precise definitions of what constitutes form or substance,¹⁸⁹ the courts have indicated that amendments that change the nature or degree¹⁹⁰ or supply a material element of the offense charged,¹⁹¹ or amendments that prejudice the defendant's ability to conduct his defense,¹⁹² would be considered inappropriate amendments of substance. Amendments to form have generally involved changes in matters such as the date of an offense that do not have any substantive effect.¹⁹³ Despite this definitional problem, the form-substance approach has clearly prevailed in North Carolina courts since at least 1896.¹⁹⁴

The prohibitory language of G.S. 15A-923(e), which became effective in July 1975, appeared to bring the state of the law in this area to a strict rule that would have prohibited all amendments even with grand jury consent.¹⁹⁵ The *Carrington* court's refusal to enforce the literal meaning of the statute sprang, presumably, from an abhorrence of such a rule and from a desire to maintain the more flexible modern approach.

In construing the mandatory language of the statute in a fashion that would permit amendment of indictments, the *Carrington* court introduced a novel definition of what kind of amendment is permissible.¹⁹⁶ The court did not explicitly refer to the traditional form-

188. See *State v. Jackson*, 280 N.C. 563, 187 S.E.2d 27 (1972); *State v. Cody*, 119 N.C. 908, 26 S.E. 252 (1896); *State v. Teel*, 24 N.C. App. 385, 210 S.E.2d 517 (1975); *State v. Peele*, 16 N.C. App. 227, 192 S.E.2d 67, *cert. denied*, 282 N.C. 429, 192 S.E.2d 838 (1972); *State v. Haigler*, 14 N.C. App. 501, 188 S.E.2d 586, *cert. denied*, 281 N.C. 625, 190 S.E.2d 468 (1972).

189. For a discussion of the problems caused by this distinction, see 41 AM. JUR. 2d *Indictments and Informations* § 181 (1968).

190. *State v. Teel*, 24 N.C. App. 385, 210 S.E.2d 517 (1975) (amendment to indictment disallowed when it changed charge from misdemeanor to felony).

191. *State v. Tarlton*, 208 N.C. 734, 182 S.E. 481 (1935) (indictment amended to add necessary element of wilfully failing to support an illegitimate child held impermissible).

192. See *State v. Haigler*, 14 N.C. App. 501, 188 S.E.2d 586, *cert. denied*, 281 N.C. 625, 190 S.E.2d 468 (1972), in which the court mentioned this factor in finding that the amendment was one of form.

193. See *State v. Helms*, 26 N.C. App. 601, 216 S.E.2d 494, *appeal dismissed*, 288 N.C. 354, 218 S.E.2d 407 (1975) (indictment amended to change date of offense); *State v. Haigler*, 14 N.C. App. 501, 188 S.E.2d 586, *cert. denied*, 281 N.C. 625, 190 S.E.2d 468 (1972) (indictment amended to change description of stolen property from "copper" to "bronze").

194. *State v. Cody*, 119 N.C. 908, 26 S.E. 252 (1896).

195. This was the strictest common law rule. See text accompanying note 186 *supra*. Prior to the enactment of § 15A-923(e), North Carolina had no statute relating to amendment of indictments.

196. The *Carrington* court's definition of a permissible amendment, one which does not "substantially alter the charge," is couched in different language than the prior North Carolina rule, which permitted amendments only in matters of form rather than substance.

substance approach. The opinion, therefore, raises the question whether its use of different language signals a break from the traditional form-substance approach or whether the new definition is meant merely to be a restatement of established law. The more logical view is that the definition presented in *Carrington* is simply this court's way of expressing the form-substance approach.¹⁹⁷ Thus, the *Carrington* decision appears to establish that North Carolina's traditional approach to allowing amendment of indictments survives the prohibitory language of G.S. 15A-923(e).

I. Presentments

In *State v. Cole*,¹⁹⁸ the North Carolina Supreme Court was faced with the problem of defining when a misdemeanor charge is initiated by presentment for the purpose of deciding whether the superior court has jurisdiction under G.S. 7A-271(a)(2).¹⁹⁹ This question was one of first impression²⁰⁰ and the court's decision fills a void in the law of superior court jurisdiction. G.S. 7A-271(a) provides limited exceptions to North Carolina's general rule that the district court has exclusive

197. The manner in which the court presented the new definition does not indicate that the court thought that it was departing from established case law. The definition is offered at the bottom of a paragraph without citations, argument or fanfare. 35 N.C. App. at 58, 240 S.E.2d at 478.

Furthermore, the differences in language do not create a meaningful distinction. Amendments found "substantive," and therefore impermissible under the form-substance approach universally affected or "substantially altered" the charge. See cases cited notes 190 & 191 *supra*. Amendments considered merely matters of form invariably did not affect or "substantially alter" the charge. See cases cited note 193 *supra*. Although it is possible to conceive of an amendment that is one of "substance" but that does not "substantially alter" the charge, it is extremely doubtful that the *Carrington* court intended to draw such a distinction. If a case should arise in which such a distinction might prove crucial, it would seem preferable to utilize the traditional form-substance approach and its established body of case law.

198. 294 N.C. 304, 240 S.E.2d 355 (1978).

199. N.C. GEN. STAT. § 7A-271(a)(2) (1969) provides in pertinent part: "The superior court has exclusive, original jurisdiction over all criminal actions not assigned to the district court division by this article, except that the superior court has jurisdiction to try a misdemeanor: . . . (2) When the charge is initiated by presentment"

North Carolina's statutory definition of a presentment is as follows:

A presentment is a written accusation by a grand jury, made on its own motion and filed with a superior court, charging a person, or two or more persons jointly, with the commission of one or more criminal offenses. A presentment does not institute criminal proceedings against any person, but the district attorney is obligated to investigate the factual background of every presentment returned in his district and to submit bills of indictment to the grand jury dealing with the subject matter of any presentment when it is appropriate to do so.

Id. § 15A-641(c) (1978).

200. The question had been considered only once before in *State v. Wall*, 271 N.C. 675, 157 S.E.2d 363 (1967). The facts of that case, however, did not present as difficult a problem as did the facts in *Cole*. See note 206 *infra*.

original jurisdiction of misdemeanor-grade criminal actions.²⁰¹ The statute states that the superior court has original jurisdiction to try a misdemeanor "[w]hen the charge is initiated by presentment."²⁰²

In *Cole*, the grand jury charged by presentments that defendants "violated the game laws of the State of North Carolina by taking and possessing a bear in Tyrrell County during closed season."²⁰³ On the same day, the indictments upon which defendants were tried were returned. They charged that defendants did unlawfully and wilfully "possess a dead game animal, a bear, which was taken during closed season in Tyrrell County."²⁰⁴ Defendants were tried in superior court and convicted of the misdemeanor. On appeal defendants argued that the charges against them were not initiated by presentment and that their cases did not fall within any of the other statutory exceptions to the general rule that the district court has exclusive original jurisdiction over misdemeanors. Defendants maintained that the judgment of the superior court was therefore void for lack of original jurisdiction.

In the first appeal of the case, the court of appeals held that the charges were not initiated by presentment and voided the judgments because the superior court lacked original jurisdiction.²⁰⁵ The court of appeals, without guidance from prior case law concerning when a

201. The general rule is found at N.C. GEN. STAT. § 7A-272(a) (1969), which provides: "Except as provided in this article, the district court has exclusive, original jurisdiction for the trial of criminal actions, including municipal ordinance violations, below the grade of felony, and the same are hereby declared to be petty misdemeanors."

202. *Id.* § 7A-271(a)(2).

203. 294 N.C. at 305, 240 S.E.2d at 357. The presentments were handed down on April 20, 1976. Defendants had originally been arrested on warrants dated November 16, 1974, which charged offenses similar to those contained in the presentments. At trial in the district court, defendants were found guilty of one count and appealed to the superior court on the ground that the warrant did not charge a crime. The conviction was reversed on this ground on September 15, 1975. On the same day, differently worded warrants that charged the same basic offense were issued. On December 5, 1975, the new warrants were dismissed in the district court for failure to state an offense. Although the State was successful in prosecuting an appeal of this order so that the warrants were resuscitated, the presentment and indictments were returned during the time period of the appeal and legal action on the indictments apparently took precedence. *Id.* at 305-06, 240 S.E.2d at 356-57.

204. *Id.* at 305-06, 240 S.E.2d at 357.

The indictments upon which defendants were tried charged a violation of N.C. GEN. STAT. § 113-103 (1978). That statute provides in part that "[t]he possession, transportation, purchase, or sale of any dead game animals . . . during the closed season in North Carolina . . . shall be unlawful." *Id.* Violation of the statute is a misdemeanor. *Id.* § 113-109.

Although trial was scheduled in district court, the cases were transferred to superior court on motion of the State with the consent of the six defendants.

205. 33 N.C. App. 48, 234 S.E.2d 191 (1977), *rev'd*, 294 N.C. 304, 240 S.E.2d 355 (1978). The court noted that defendants agreed to the State's motion to transfer the case to superior court but held that the agreement could not confer jurisdiction on a court that never properly had it. *Id.* at 51, 234 S.E.2d at 193.

charge is initiated by presentment,²⁰⁶ adopted a narrow, formal definition of the term. First the court examined both instruments and concluded that the offense charged in the presentment was different from the offense charged in the indictments.²⁰⁷ The court of appeals then held that, because the actual offenses charged in the instruments were different, the charges upon which the defendants were tried—those in the indictments—were not initiated by presentment.²⁰⁸

The North Carolina Supreme Court overruled the court of appeals and held that the superior court did have original jurisdiction because the charges were initiated by presentment.²⁰⁹ In so doing, the court adopted a less formal definition of when a charge is initiated by presentment. Its approach to the problem proceeded from an analysis of the role that the presentment has played in the criminal justice system. The court stated that the presentment is a device by which the grand jury brings "subject matter"²¹⁰ to the attention of the district attorney and is *not* a formal document that initiates criminal proceedings.²¹¹

206. Although the supreme court had considered this problem in *State v. Wall*, 271 N.C. 675, 157 S.E.2d 363 (1967), the facts of that case did not fairly raise the real issue discussed in *Cole*. In *Wall*, defendant was arrested on two warrants. Later two indictments, both charging misdemeanors, were returned against him. The grand jury never returned a presentment against defendant. Defendant was originally tried and convicted in superior court and appealed on the ground that the district court had exclusive original jurisdiction. The court stated that the "initiated by presentment" exception to the general rule that the district court has exclusive original jurisdiction over misdemeanors did not apply in *Wall* because no presentment was ever returned and the cases were in fact initiated by the warrants.

207. The court of appeals noted that, while the presentment alleged that defendants violated the law by "taking and possessing a bear . . . during closed season," the indictment charged that defendants violated the law by "possessing a dead game animal . . . in violation of G.S. 113-103." The court stated that the charge in the presentment of "taking and possessing" was not the same as the charge in the indictment of "possessing a dead game animal," upon which defendants were tried. 33 N.C. App. 48, 51, 234 S.E.2d 191, 193 (1977).

208. *Id.*

209. Although the court reversed on this issue, the ultimate holding of the court was in defendant's favor. After disposing of the jurisdiction issue, the court vacated the judgments and quashed the indictments on the ground that the bills of indictment did not charge a crime. 294 N.C. at 310, 240 S.E.2d at 559. The indictment had alleged a violation of N.C. GEN. STAT. § 113-103 (1978), which makes it a misdemeanor to "possess . . . any dead game animals . . . during the closed season." Defendants were arrested possessing a bear on a date that is inside North Carolina's state-wide "open season" on bear. *Id.* § 113-100. Although chapter 103 of the 1973 Session Laws made it unlawful to "take or hunt bear in the County of Tyrrell" during the time of the alleged offense, that law did not make mere possession of a dead bear a crime. Law of March 26, 1973, ch. 103, § 1, 1973 N.C. Sess. Laws 83. The court refused to construe the two statutes in conjunction and held that no actual offense had been charged in the indictments.

210. 294 N.C. at 308, 240 S.E.2d at 358.

211. The court cited both statutory and case law to support its position on the function of the presentment and stated that N.C. GEN. STAT. § 15A-641(c) (1978), quoted in note 199 *supra*, supported its less formal view of the presentment's function. 294 N.C. at 308, 240 S.E.2d at 358.

The court further stated that the statute only codified and clarified the holding of the landmark case of *State v. Thomas*, 236 N.C. 454, 73 S.E.2d 283 (1952). That case reviewed the

The court concluded that because it is not the function of the presentment to charge a specific crime or initiate criminal proceedings, a charge in an indictment could be initiated by presentment even though the instruments might charge different offenses.²¹² Approaching the word "initiated" in a common-sense manner, the court stated that the charges in the indictment were initiated by presentment because the indictment "dealt with the same factual subject matter"²¹³ as the presentment. It seems then, that the rule adopted by the court in *Cole* is that a charge in an indictment is initiated by presentment if the presentment addresses the subject matter out of which the charge in the indictment grows.

The supreme court's historical and functional analysis rendered the court of appeals' approach irrelevant. Because the presentment is only intended to be a communication from the grand jury to the prosecutor, it would be too much to expect the presentment and the eventual indictment to contain identical charges. The court of appeals' approach would have rendered the statutory provision granting the superior court jurisdiction when the charge is initiated by presentment meaningless for practical purposes. The supreme court's approach better accords with the true function of the grand jury presentment.

J. Joinder of Offenses

In *State v. Greene*,²¹⁴ the North Carolina Supreme Court was faced with the problem of interpreting G.S. 15A-926(a),²¹⁵ the section of the 1973 Criminal Procedure Act that deals with joinder of offenses. In contrast to its predecessor statute, which permitted joinder of offenses when the offenses charged were "of the same class of crimes or

modes of prosecution and concluded that the presentment is "nothing more than an instruction by the grand jury to the public prosecuting attorney for framing a bill of indictment for submission to them." *Id.* at 458, 73 S.E.2d at 286.

212. The court stated that the presentment in *Cole* successfully fulfilled the very role it is assigned to play in our criminal justice system; the grand jury alerted the prosecutor to a problem via a presentment and the prosecutor later returned to the grand jury an indictment that dealt with the same factual subject matter. 274 N.C. at 308-09, 240 S.E.2d at 358.

213. *Id.* at 309, 240 S.E.2d at 358.

214. 294 N.C. 418, 241 S.E.2d 662 (1978).

215. N.C. GEN. STAT. § 15A-926(a) (1978). The statute, which became effective on July 1, 1975, reads:

Two or more offenses may be joined in one pleading or for trial when the offenses, whether felonies or misdemeanors or both, are based on the same act or transaction or on a series of acts or transactions connected together or constituting parts of a single scheme or plan. Each offense must be stated in a separate count as required by G.S. 15A-924.

offenses,"²¹⁶ the new statute provides that offenses can be joined only if they are "based on the same act or transaction or on a series of acts or transactions connected together or constituting parts of a single scheme or plan."²¹⁷

In *Greene*, defendant was charged in three separate bills of indictment with assault with intent to commit rape against one victim, and rape and kidnapping of a second victim.²¹⁸ All three charges were consolidated for trial over defendant's objection that joinder of the charge relating to one victim with the charges relating to the other victim violated G.S. 15A-926(a) and was prejudicial to his defense because it allowed the jury to hear the testimony of both victims.²¹⁹ The jury found defendant not guilty of the kidnapping charge but returned verdicts of guilty of assault with intent to commit rape on the other two charges.

On appeal, the supreme court held that the joinder of offenses in *Greene* was proper under the statute and nonprejudicial to defendant. Justice Exum concurred, stating that the offenses were not joinable under the statute but that the erroneous consolidation was harmless error.

The majority held that the joinder of offenses in *Greene* was proper under G.S. 15A-926(a) because the sexual assaults were "parts of a single scheme or plan."²²⁰ That scheme was defendant's effort "within a time span of three hours . . . to satisfy his sexual desires on the afternoon of 3 May 1976."²²¹ Although the *Greene* court did not state a standard by which one can determine whether the G.S. 15A-926(a) requirement is met, two factors seemed to have been especially

216. Law of March 6, 1917, ch. 168, 1917 N.C. Pub. Laws 319 (formerly codified as amended at N.C. GEN. STAT. § 15-152) (repealed 1974).

217. N.C. GEN. STAT. § 15A-926(a) (1978).

This is a welcome change. Joinder of unrelated offenses simply because they are of the same class has been heavily criticized. See ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, STANDARDS RELATING TO JOINDER AND SEVERANCE § 2.2(a), at 29 (1968). Because the offenses are distinct, the public gain from joinder for trial of unrelated offenses in terms of trial efficiency is minimal compared to the great possibility of prejudice to defendants in such trials.

218. The State alleged that the first offense occurred around 2:00 p.m. when defendant, posing as a painter, gained admission to the first victim's apartment and unsuccessfully attempted to rape her. The second and third offenses occurred later that afternoon when defendant picked up the second victim, who was hitchhiking on the highway, and drove her to a wooded area and raped her.

219. 294 N.C. at 420, 241 S.E.2d at 663.

Defendant did not contend that it was error to consolidate the two charges growing out of the second incident. Defendant apparently argued that joinder of the first charge with the later two charges was improper because the offenses were not parts of a "single scheme" as required by the statute. *Id.* at 421-22, 241 S.E.2d at 664-65.

220. *Id.* at 422, 241 S.E.2d at 665.

221. *Id.*

important to the court in reaching its determination that a single scheme was present. First, the court stated that, although the new statute does not allow joinder on the basis that the offenses are of the same class, "the nature of the offenses is one of the factors which may properly be considered in determining whether certain acts or transactions constitute 'parts of a single scheme or plan' as those words are used in present G.S. 15A-926(a)."²²² The offenses charged in *Greene* were obviously of the same class.

Second, case law under the old joinder statute recognized that an important factor in determining the propriety of joinder was whether evidence on one charge would be admissible at a separate trial on the other charge.²²³ The court stated that in *Greene*, evidence of the offenses committed against one victim was admissible in the case charging offenses against the other victim for the purpose of establishing defendant's identity as the assailant.²²⁴ The court also determined that evidence from one case was admissible in the other for the alternative purpose of establishing "defendant's intent and plan and design to commit the crimes, or, in the language of the statute, to show a 'single scheme or plan.'"²²⁵ The court thus intimated that offenses can be properly joined under G.S. 15A-926(a) if evidence from one case can properly be used in another case under any of the other crimes exceptions to the general rule that prohibits admission of evidence of separate and unrelated offenses at trial.²²⁶ At any rate, it is clear that the court would find the statutorily required single scheme and thus permit joinder whenever similar evidence would be admissible in separate cases under the particular other crimes exceptions that permit introduction of other offenses to prove intent, plan, or design.²²⁷

222. *Id.* (quoting *State v. Greene*, 34 N.C. App. 149, 152, 237 S.E.2d 325, 327 (1977), *aff'd*, 294 N.C. 418, 241 S.E.2d 662 (1978)).

223. It was generally held that joinder of offenses was appropriate when "the offenses charged are of the same class and are so connected in time and place that evidence at trial upon one indictment would be competent and admissible on the other." *State v. Taylor*, 289 N.C. 223, 230, 221 S.E.2d 359, 364 (1976). Although it is difficult to determine how much weight the evidence factor alone has played in favor of joinder, it is clear that it has been important.

224. 294 N.C. at 423, 241 S.E.2d at 665.

225. *Id.*

226. The general rule is that evidence of separate and unrelated offenses, "other crimes," is not admissible for the purpose of proving the accused's guilt of a crime. Evidence of "other crimes" is admissible, however, if introduced for other, proper purposes. Some of these proper purposes are to show knowledge, intent, motive, plan or design, or identity. STANSBURY, *supra* note 31, §§ 91-99.

227. The purpose of proving intent and the purpose of proving plan and design are different and are treated separately by the commentators. *See id.* § 92; 2 J. WIGMORE, EVIDENCE § 304 (3d ed. 1940). Evidence that tends to prove plan or design, however, may in some cases show intent.

Justice Exum stated in his concurrence that the offenses were improperly joined in violation of G.S. 15A-926(a) because the two incidents were not part of a single scheme. In his view, a single scheme permitting joinder of offenses does not exist unless similar evidence could be admitted in separate cases under the particular other crimes rule exception that permits introduction of another offense to prove the defendant's *plan* or *design* to commit the crime charged. This standard is to be distinguished from the standard the majority intimated is appropriate. At the very least, the majority approved joinder when evidence that proves *intent*, plan, or design could be used in different cases. The concurrence would approve joinder only when evidence from one case could be used to prove plan or design in a separate case—a more rigorous standard than that of the majority. Justice Exum stated that in order for joinder to be appropriate, defendant's pattern of conduct must contain more than “‘mere similarity [of act], which suffices for evidencing intent,’” but “‘such a concurrence of common features that the various acts are naturally to be explained as caused by a general plan of which they are the individual manifestations.’”²²⁸ In *Greene* the differences in the modus operandi employed by the defendant proved that defendant did not have a single scheme as that phrase is understood in the other crimes exception. Therefore, Exum contended, the statutory criteria for joinder of offenses, the existence of a single scheme, was not present. Justice Exum declared that the majority was in effect disregarding and nullifying the new statutory joinder rule.²²⁹

On the question of prejudice, the majority first stated the general rule that joinder of offenses should not be permitted, even if allowed by statute, if the defendant would suffer unfairly.²³⁰ In determining whether an accused has been prejudiced by joinder the court stated that the question to be asked is “‘whether the offenses are *so separate in time and place* and *so distinct in circumstances* as to render a consolidation

228. 294 N.C. at 424, 241 S.E.2d at 666 (concurring opinion) (quoting 2 J. WIGMORE, *supra* note 227).

229. *Id.* at 425, 241 S.E.2d at 666.

230. *Id.* at 421, 241 S.E.2d at 664. Because a motion for severance of offenses is addressed to the discretion of the court, rulings on this matter are not overturned absent abuse of discretion. *State v. Davis*, 289 N.C. 500, 508, 223 S.E.2d 296, 301 (1976). North Carolina courts are not prone to reverse trial court decisions in favor of joinder on the ground of unfair prejudice to the defendant. The situation in North Carolina seems to be similar to the national situation in which “appellate reversal of a trial court’s decision not to grant a severance is extremely rare.” ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, *supra* note 217, § 2.2(a), at 30.

unjust and prejudicial to defendant.'"²³¹ The court determined that the record did not disclose such prejudice. Its earlier determination that evidence of one crime would be admissible in a separate trial of the other offense was undoubtedly an important factor in its conclusion that defendant suffered no prejudice.

Justice Exum accepted the majority's standard for measuring prejudice and agreed that defendant in *Greene* was not unfairly prejudiced by the joinder. He therefore concluded that the erroneous consolidation was harmless error because, although evidence of the other offenses would not have been admissible in separate trials for the purpose of proving the existence of a plan under the other crimes exception, evidence of the other offenses would have been admissible in separate trials for the purposes of proving questions of intent and consent.²³² Because the evidence would have been heard in separate trials, the consolidation did not prejudice defendant.

Greene is the first case in which the courts have closely examined the problem of joinder of offenses under G.S. 15A-926(a).²³³ The statutory requirement of a "single scheme or plan" seems to imply that joinder is appropriate only when the series of alleged criminal acts are connected in some systematic, planned way. Yet offenses may be introduced to prove intent under the other crimes exception that are related

231. 294 N.C. at 423, 241 S.E.2d at 665 (quoting *State v. Johnson*, 280 N.C. 700, 704, 187 S.E.2d 98, 101 (1972)). This standard was enunciated in *State v. White*, 256 N.C. 244, 247, 123 S.E.2d 483, 486 (1961).

By statute, the court is required to grant severance of offenses whenever it is necessary for "a fair determination of the defendant's guilt or innocence of each offense." N.C. GEN. STAT. § 15A-927(b) (1978).

232. 294 N.C. at 425, 241 S.E.2d at 666 (concurring opinion).

233. This question has been focused on in only three cases, none of which set any interpretative standards. The facts in *Greene* certainly were the most difficult yet presented for determining whether joinder of offenses was appropriate.

In *State v. Creech*, 37 N.C. App. 261, 245 S.E.2d 817, *cert. denied*, 295 N.C. 554, 248 S.E.2d 731 (1978), charges of rape, kidnapping and crime against nature were consolidated. Evidence showed that defendant picked up the victim on the highway in his car, took her to a remote area, and performed oral sex. The court held that joinder was proper under the statute because the offenses were "a series of acts or transactions . . . connected together." *Id.* at 263, 245 S.E.2d at 819 (quoting § 15A-926(a)).

In *State v. Irick*, 291 N.C. 480, 231 S.E.2d 833 (1977), two burglary charges and two charges of assault on a law officer with a firearm were consolidated over defendant's objection that joinder was improper under the statute. Evidence showed that the burglaries occurred within one neighborhood in a two hour time span and that the confrontation with the police took place as defendant was leaving the area. The court stated that the evidence showed a "common plan." *Id.* at 487-88, 231 S.E.2d at 839.

In *State v. Karbas*, 28 N.C. App. 372, 221 S.E.2d 98, *cert. denied*, 289 N.C. 618, 223 S.E.2d 394 (1976), the court held that consolidation of a manslaughter charge and a driving under the influence charge, both of which grew out of one automobile accident, was proper under the statute because the offenses were based on the "same transaction." *Id.* at 374, 221 S.E.2d at 100.

to the alleged offense only because of the general similarity of act, and that are clearly not part of a common purpose or systematic scheme.²³⁴ Therefore, a standard that permits joinder of offenses when an offense could be introduced to prove intent will not ensure that the joined offenses constituted a "single scheme or plan" within the apparent meaning of the statute. The other crimes exception that permits introduction of other offenses to prove plan and design requires that the offenses have features so common that they indicate the existence of a specific pattern or scheme.²³⁵ This standard would better ensure that the joined offenses truly constitute a "single scheme or plan." Justice Exum's approach thus seems more in keeping with the language of the statute than the majority's approach.

Adoption of Justice Exum's interpretation of the statutory requirement would not, however, as the *Greene* case vividly illustrates, require reversals of convictions when joinder was improperly allowed under that strict standard. Justice Exum concluded that the erroneous consolidation in *Greene* was harmless error because evidence on the issues of intent and consent would have been admissible in separate trials. It thus appears that, even under Justice Exum's view, operation of the harmless error rule may protect consolidations made in violation of the statute whenever evidence of the joined offenses could have been properly introduced to prove an issue in a separate trial. If this view prevails it will render the statutory single scheme requirement meaningless in cases such as *Greene*, and make it very difficult for criminal defendants to complain about improper joinder of offenses.

One solution to this problem would be for North Carolina to adopt Rule 472 of the Uniform Rules of Criminal Procedure.²³⁶ This rule generally leaves to the criminal defendant the option to sever the charges against him if he so desires, notwithstanding that the charged offenses are related.²³⁷ Another solution would be for the courts to

234. 2 J. WIGMORE, *supra* note 227, § 302, at 200. Wigmore states that "the prior doing of other similar acts . . . the mere repetition of instances, and not their system or scheme" is the crucial factor in the admissibility of evidence to prove intent. *Id.*

235. *Id.* § 304. Although the difference between the requirements for introduction of evidence to prove intent and plan or design is one of degree rather than kind, the distinction is a real one. In order to illustrate the distinction Wigmore cites an example in which, in order to prove that *A* committed a fraud on *B*, proof that *A* committed a fraud on *C* is irrelevant. It would be relevant only for the purpose of showing intent once the fraud was admitted by *A*. If it could be shown, however, that the fraud on *B* was one of a class having common features with prior frauds committed by *A*, the prior frauds are relevant for the purpose of proving guilt because they illustrate common scheme or design.

236. See UNIFORM RULES OF CRIMINAL PROCEDURE 472(a).

237. The only limitation on the defendant's right to sever offenses is the court's power to deter-

make more frequent use of their inherent power to refuse to join offenses when consolidation would prejudice the defendant.²³⁸ When the *Greene* court considered this problem, it ignored the statutory standard for measuring prejudice in this area and utilized a measure for prejudice that put far too heavy a burden on the defendant.²³⁹ Many serious problems are created for criminal defendants when offenses are joined,²⁴⁰ and North Carolina courts should be more responsive to potential joinder problems. The statutory standard for joinder of offenses that Justice Exum proposed in *Greene* should be adopted and the inherent judicial power to refuse potentially prejudicial joinders should be readily used when necessary.

K. Discovery

The North Carolina Supreme Court decided two appeals based on the prosecution's failure to comply with discovery motions. In *State v. Jones*,²⁴¹ the court held that defendant was entitled to a new trial when the prosecutor had withheld material and exculpatory information in response to a voluntary discovery request with which he had otherwise complied. In *State v. Stevens*,²⁴² the court refused to grant relief, holding that failure of the prosecution pursuant to defendant's discovery motion to disclose oral statements made by defendant to police did not require their exclusion at trial.

In *Jones*, an arson case, the prosecution, in response to a request for voluntary discovery, failed to disclose a laboratory report²⁴³ con-

mine that severance would defeat the ends of justice because of risk of loss of material evidence. See *id.*

238. See text accompanying notes 232 & 233 *supra*.

239. See text accompanying note 233 *supra*.

240. See generally ABA PROJECT ON MINIMUM STANDARDS FOR CRIMINAL JUSTICE, *supra* note 217; Maguire, *Proposed New Federal Rules of Criminal Procedure*, 23 ORE. L. REV. 56 (1943); Note, *Joint and Single Trials Under Rules 8 and 14 of the Federal Rules of Criminal Procedure*, 74 YALE L.J. 553 (1965). It has been observed:

[I]f you can pile up a number of charges against a man, it is quite often the case that the jury will convict, where, if they were listening to the evidence on one charge only, they would find it wholly insufficient as to the degree of proof required.

Maguire, *supra*, at 58-59.

Joinder of offenses creates a dilemma for the defendant who wishes to testify in his own behalf regarding some of the joined offenses. In *Cross v. United States*, 335 F.2d 987 (D.C. Cir. 1964), the court encountered such a situation and found sufficient prejudice to require a new trial. In a recent case, *State v. Creech*, 37 N.C. App. 261, 245 S.E.2d 817, *cert. denied*, 295 N.C. 554, 248 S.E.2d 731 (1978), the court rejected defendant's argument that he had been prejudiced in this manner.

241. 296 N.C. 75, 248 S.E.2d 858 (1978).

242. 295 N.C. 21, 243 S.E.2d 771 (1978).

243. The laboratory report indicated that no inflammable accelerants were found in defend-

taining potentially exculpatory information.²⁴⁴ The prosecutor had agreed to comply and had furnished some material in response, but, apparently through oversight, never informed defendant of the existence of or information contained in the laboratory report. Defendant learned of the report only after his conviction and moved for relief on the ground that material evidence that had been unavailable to him and that could not with due diligence have been discovered by him at trial²⁴⁵ was now available. The State contended that defendant had not exercised due diligence in discovering the evidence because he had not moved for court-ordered discovery. The court's reasoning in rejecting this contention was sound. A motion to compel discovery may be made only after there has been some indication that the party from whom discovery is sought will not fully comply.²⁴⁶ In this case, because the prosecutor had agreed to comply and had partially complied, defendant had no reason to know the prosecutor had not fully complied and thus had no grounds for seeking court-ordered discovery.

By emphasizing the reasonableness of defendant's actions in light of the surrounding circumstances, the court's interpretation should produce equitable and reasonable results and will promote use of voluntary discovery. Had the court adopted the State's interpretation, voluntary discovery in criminal prosecutions would become merely a token gesture prior to court-compelled discovery, in order that defendants could protect their statutory rights.

In *Stevens*, the second discovery case decided by the supreme court, the district attorney replied in answer to a request for discovery that he had no oral statement of defendant that he intended to offer in evidence at trial.²⁴⁷ He actually did possess summaries of defendant's oral statements, but, because they were largely exculpatory, did not in-

ant's outer clothing. 296 N.C. at 78-79, 248 S.E.2d at 860. The investigating officer testified that he had smelled kerosene on defendant when he arrived at the scene. *Id.* at 76, 248 S.E.2d at 859.

244. The request, in part, was for material discoverable by court order under N.C. GEN. STAT. § 15A-903(e) (1978). 296 N.C. at 79, 248 S.E.2d at 860. This provision provides for discovery of "results or reports of physical or mental examinations or of tests, measurements or experiments made in connection with the case, . . . within the possession, custody, or control of the State, the existence of which is known or by the exercise of due diligence may become known to the prosecutor." N.C. GEN. STAT. § 15A-903(e) (1978).

245. This ground is contained in N.C. GEN. STAT. § 15A-1415(b)(6) (1978).

246. There must be no response, or a negative or unsatisfactory one. 296 N.C. at 80, 248 S.E.2d at 861; see N.C. GEN. STAT. § 15A-902(a) (1978).

247. 295 N.C. at 37, 243 S.E.2d at 781. It appeared that this response was purely voluntary on the part of the prosecutor since defendant had not requested this information under N.C. GEN. STAT. § 15A-903(a)(2) (1978). The court found it unnecessary to decide whether the prosecutor's response obviated the need for such a request. 295 N.C. at 37, 243 S.E.2d at 781.

tend to use them in his case. At trial, defendant took the stand and gave testimony that was inconsistent with those prior oral statements. In rebuttal, the district attorney sought to introduce the oral statements and defendant objected. The court overruled the objection, but granted a continuance to allow defense counsel time to examine the statements.²⁴⁸

On appeal, defense counsel argued that his client was prejudiced because, had counsel known the substance of the oral statements, he would not have allowed defendant to take the stand.²⁴⁹ The court summarily rejected this contention, saying that the discovery procedures could not be used to protect perjury.²⁵⁰ The remedy employed here, a continuance, was sufficient to protect against the introduction of surprise evidence.²⁵¹ Of greater importance was the court's discussion of the meaning of G.S. 15A-903(a)(2), the statute providing for discovery of defendant's oral statements "which the State intends to offer in evidence at the trial."²⁵² Although the court did not seek to define the limits of intent, it did indicate that subjective intent, or intent to use in the case in chief was not the proper interpretation, since this would circumvent the purpose of the statute.²⁵³ The court, instead, preferred to advise the prosecution to comply fully with the legislative intent to permit broad discovery and disclose all material that might be used at trial.²⁵⁴ While this case gives no definitive ruling on the meaning of G.S. 15A-903(a)(2),²⁵⁵ it does indicate judicial approval of liberal discovery and gives a practical framework within which both defense and prosecution would be well-advised to work.

L. Identification of Defendant

The North Carolina Court of Appeals in *State v. Connally*²⁵⁶ interpreted and applied the test of admissibility for unnecessarily suggestive pretrial identification procedures recently enunciated by the United

248. 295 N.C. at 36, 243 S.E.2d at 780.

249. *Id.* at 37, 243 S.E.2d at 781.

250. *Id.*

251. The court stated that the remedy utilized here would have been proper had there been a motion under N.C. GEN. STAT. § 15A-903(a)(2) (1978). Therefore, it was unnecessary to reach defendant's contention that the district attorney's reply excused the necessity of making the motion. 295 N.C. at 37, 243 S.E.2d at 781.

252. N.C. GEN. STAT. § 15A-903(a)(2) (1978).

253. 295 N.C. at 36-37, 243 S.E.2d at 780-81.

254. *Id.* at 37, 243 S.E.2d at 781.

255. N.C. GEN. STAT. § 15A-903(a)(2) (1978).

256. 36 N.C. App. 43, 243 S.E.2d 788 (1978).

States Supreme Court in *Manson v. Brathwaite*.²⁵⁷ The *Manson* test evaluates reliability of the suggestive pretrial identification according to the following factors: "the opportunity of the witness to view the criminal at the time of the crime, the witness' degree of attention, the accuracy of his prior description of the criminal, the level of certainty demonstrated at the confrontation, and the time between the crime and the confrontation."²⁵⁸ These factors are to be weighed against the "corrupting effect"²⁵⁹ of the suggestive identification.

In *Connally*, defendant was charged with uttering a forged instrument.²⁶⁰ He presented an alibi defense, the essence of which was that he had not been in Reidsville, the city where the check was uttered, on the day of the crime.²⁶¹ In rebuttal, the State presented Moody, a salesclerk, to testify that defendant had been in his store in Reidsville on that day.²⁶² Defendant made a prior objection to Moody's identification testimony and moved for a *voir dire* hearing to determine its admissibility.²⁶³ The court denied the motion, refusing to hold *voir dire*, and Moody identified defendant as having been present in his store on that day.²⁶⁴ On cross-examination, defendant elicited the details of Moody's observations of defendant, both in the store and at the pretrial show-up where he first identified defendant.²⁶⁵ The court of appeals held that failure to hold *voir dire* was prejudicial error under these circumstances and remanded for a new trial.²⁶⁶

In deciding whether the judge's error was prejudicial, the court appeared to use a two-step analysis, incorporating the *Manson* test for admissibility of identification evidence derived from an unnecessarily suggestive pretrial procedure. The court first sought to determine whether the pretrial procedure met the *Manson* standards of reliability.

257. 432 U.S. 98 (1977). In *Manson*, the suggestiveness of pretrial procedures was already established; the question was what standard should be applied to determine the resulting identification's admissibility.

258. *Id.* at 114 (quoting *Neil v. Biggers*, 409 U.S. 188, 199-200 (1972)).

259. *Id.*

260. He was also charged with breaking and entering, larceny, and forgery of the uttered check. 36 N.C. App. at 44, 243 S.E.2d at 789. The identification issue arose with respect to the uttering charge only.

261. *Id.* at 45, 243 S.E.2d at 790.

262. *Id.*

263. *Id.* at 48, 243 S.E.2d at 792. A *voir dire* hearing upon the competency of a witness to identify the defendant is required any time a defendant makes a timely objection to the testimony and requests that a *voir dire* be held. See *State v. Waddell*, 289 N.C. 19, 220 S.E.2d 293 (1975), modified on other grounds, 428 U.S. 904 (1976).

264. 36 N.C. App. at 48, 243 S.E.2d at 792.

265. *Id.* at 49-50, 243 S.E.2d at 793.

266. *Id.* at 50-51, 243 S.E.2d at 793.

Although it is not clear from the opinion,²⁶⁷ the court apparently made this inquiry because under the first step of the test, if it finds that the pretrial procedure was reliable, it then will hold that the failure to conduct *voir dire* was harmless error. By definition, *reliable* pretrial identification evidence is not "so impermissibly suggestive as to give rise to a very substantial likelihood of irreparable misidentification."²⁶⁸ If the pretrial procedure is found to be unreliable, then the court will proceed to decide whether the in-court identification was likely to have been tainted by the pretrial procedure,²⁶⁹ the test formulated in *Simmons v. United States*.²⁷⁰

Under the *Connally* facts, the court found that the show-up confrontation did not meet the *Manson* standards of reliability²⁷¹ because Moody observed defendant for only a few minutes in a crowded store, had no reason to pay particular attention to defendant, gave no accurate description of him and the show-up occurred two months after the in-store observation.²⁷² The court did not rule on the admissibility of Moody's in-court identification,²⁷³ but hinted that its admissibility was doubtful²⁷⁴ since the standards for determining the admissibility of in-court identification are similar to those for pretrial confrontations.²⁷⁵

The decision in *Connally* is unlikely to have a significant impact on the conduct of the trial,²⁷⁶ and may have only a limited effect in the appellate courts. Without the *Connally* test, the identification issue would be decided under the *Simmons* test by determining whether

267. The court applied the *Manson* test without articulating a reason, *id.* at 49, 243 S.E.2d at 792, but since the pretrial identification evidence was presented by defendant and not the prosecution, its admissibility was not in issue. Therefore, it is reasonable to conclude that the reliability of the pretrial identification was used as an indicium of the prejudice, or lack thereof, resulting from failure to hold *voir dire* on the admissibility of the in-court identification.

268. *Simmons v. United States*, 390 U.S. 377, 384 (1968). This is the test for determining whether the in-court identification is impermissibly tainted by the suggestive pretrial procedure.

269. *Id.* If the in-court identification is tainted, then failure to hold *voir dire* is prejudicial error; if it is not tainted, the error is harmless.

270. 390 U.S. 377 (1968).

271. The court stated that the initial observation of defendant did not meet the reliability standards of *Manson*, 36 N.C. App. at 50, 243 S.E.2d at 793, but probably intended to refer to the pretrial procedure since that was the concern of *Manson*.

272. *Id.*

273. The court remanded the case for a new trial rather than a *voir dire* because failure to hold the hearing had forced defendant to bring before the jury the pretrial identification and the details of the initial observation. Thus, remand for *voir dire* would not cure the trial error. *Id.*

274. *Id.*

275. See *Simmons v. United States*, 390 U.S. 377 (1968); *Stovall v. Denno*, 388 U.S. 293 (1967).

276. The *Connally* test does not alter the requirements of when a *voir dire* hearing must be held, see note 263 *supra*; it merely formulates a new means to test the effects of the error in failing to hold *voir dire*.

there exists a substantial likelihood that the in-court identification was tainted by the pretrial procedure. Because the two tests involve weighing many of the same factors, cases in which the *Connally* test is dispositive and the older is not will be rare. Thus, the cases in which the *Connally* test will prove to be useful are likely to be few.

M. Jury Argument

The North Carolina Supreme Court, in *State v. Walters*,²⁷⁷ held that the right to inform the jury of the statutory punishment for the crimes charged applies to offenses for which there is no mandatory sentence. In *Walters*, defendant was tried for second degree murder. At trial, defense counsel requested and was denied permission to read to the jury the statutory provisions prescribing the punishments for first and second degree murder²⁷⁸ and for voluntary and involuntary manslaughter.²⁷⁹ Defendant was convicted of voluntary manslaughter and given a fifteen year sentence. The court held that refusal to allow defense counsel to read the provisions relating to second degree murder and manslaughter was error and that prejudice resulted from the denial with respect to the manslaughter provisions, entitling defendant to a new trial.²⁸⁰

North Carolina courts have recognized the right to read punishment provisions²⁸¹ in the cases of murder and first degree burglary,²⁸² both of which offenses carry mandatory punishment provisions. *Walters* is the first case to apply the right to an offense without a mandatory sentence. The manslaughter statute that defendant requested to read provides for a sentence of not less than four months nor more than twenty years for voluntary manslaughter, and for a fine or imprisonment in the discretion of the court for involuntary manslaughter.²⁸³ The judge's refusal to allow this statute to be read resulted in

277. 294 N.C. 311, 240 S.E.2d 628 (1978).

278. N.C. GEN. STAT. § 14-17 (Cum. Supp. 1977).

279. *Id.* § 14-18 (1969).

280. 294 N.C. at 314, 240 S.E.2d at 630.

281. The right is based on N.C. GEN. STAT. § 84-14 (1975), which allows the whole case—law as well as fact—to be argued to the jury.

282. *See, e.g., State v. Irick*, 291 N.C. 480, 231 S.E.2d 833 (1977); *State v. McMorris*, 290 N.C. 286, 225 S.E.2d 553 (1976).

283. N.C. GEN. STAT. § 14-18 (1969). The manslaughter statute has been modified by case law to limit sentences for involuntary manslaughter to a maximum of 10 years. *State v. Adams*, 266 N.C. 406, 146 S.E.2d 505 (1966) (punishment for involuntary manslaughter as provided by statute held not to be specific); *see* N.C. GEN. STAT. § 14-2 (Cum. Supp. 1977). The court assumed that the jury may be informed of this case law modification but did not expressly so hold. 294 N.C. at 315, 240 S.E.2d at 631. Because the appeal dealt with the reading of statutory provi-

prejudice to defendant.²⁸⁴

The purpose of the right to read sentencing provisions is to impress upon the jury the seriousness of its duty and to encourage it to give the decision its full and careful consideration.²⁸⁵ The purpose is *not* to allow the jury to reach its verdict on the basis of the punishment for each possible offense; this consideration should be irrelevant to the jury's decision.²⁸⁶ In light of the right's intended purpose, it would seem that the refusal to inform the jury of the punishment for second degree murder would be just as prejudicial as the refusal of the reading of the manslaughter provision.²⁸⁷ In *Walters*, the court stated that the judge's error had hampered the defense "in shaping his argument to persuade the jury . . . that defendant should be acquitted on the ground of self-defense or, at most, convicted of involuntary manslaughter only."²⁸⁸ The court's language does not reflect the presently recognized purpose of the statute, to impress upon the jury the gravity of its duty. Because the court recognized that refusal to allow the jury to be informed of the punishment provisions impairs defendant's jury argument, *Walters* tacitly broadens the purpose of the right and, to some extent, allows defense counsel to use the punishment information to argue the propriety of certain sentences for the conduct charged.

N. Prisoners' Rights

In *Bolding v. Holshouser*,²⁸⁹ a divided panel²⁹⁰ of the United States Court of Appeals for the Fourth Circuit reversed an earlier dismissal of a section 1983²⁹¹ civil rights suit brought by twenty-nine North Carolina prisoners in the United States District Court for the Western Dis-

sions only, the inclusion of case law in the punishment information should not be assumed to have been definitively established.

284. 294 N.C. at 314, 240 S.E.2d at 630.

285. *Id.* at 314, 240 S.E.2d at 630; *State v. McMorris*, 290 N.C. 286, 288, 225 S.E.2d 553, 554 (1976).

286. *E.g.*, *State v. Watkins*, 283 N.C. 504, 508, 196 S.E.2d 750, 753 (1973); *State v. Rhodes*, 275 N.C. 584, 588, 169 S.E.2d 846, 848 (1969).

287. The question of prejudice arises only when there is a substantial likelihood that, absent the error, a different result would have been obtained. The test employed by the court was whether the evidence of guilt was overwhelming. Under the *Walters* facts, the court found the evidence of guilt not to be overwhelming. 294 N.C. at 315, 240 S.E.2d at 631.

288. *Id.*

289. 575 F.2d 461 (4th Cir.), *cert. denied*, 99 S. Ct. 121 (1978).

290. A subsequent poll of the full court failed to get the necessary votes to rehear the case. In an addendum to the opinion three judges recorded their dissent from the failure to rehear the case *en banc*. *Id.* at 467 (dissenting opinion). Senior Circuit Judge Field also filed an addendum to the opinion in which he expressed complete accord with the panel dissent. *Id.* at 471.

291. 42 U.S.C. § 1983 (1976).

trict of North Carolina.²⁹² The prisoner petitioners, as individuals and as representatives of a class composed of all North Carolina prisoners, sought a declaratory judgment that certain prison conditions violated their federal and state constitutional rights.²⁹³ The suit also prayed for comprehensive injunctive relief²⁹⁴ that, if granted, would involve the federal judiciary in the operation of the entire North Carolina prison system. The district court granted defendants' motion under Federal Rule of Civil Procedure 12(b)(6) on the ground that the complaint set forth legal conclusions unsupported by adequate factual allegations. The district court also stated that it would not grant class relief in this or any similar case because it was unwilling "to take under its control and management the prison system [of North Carolina]."²⁹⁵

After a short discussion of the concept of notice pleading embodied in the federal rules,²⁹⁶ the court of appeals held that the majority of the complaint was improperly dismissed because it did contain "factual allegations sufficient to state a cognizable claim."²⁹⁷ While the court

292. The opinion of the district court is not reported. The 29 plaintiffs were incarcerated in 13 penal institutions in various locations in North Carolina. Defendants were the Governor of North Carolina and various officials of the North Carolina Department of Corrections.

Because only eight of the plaintiffs were confined in prisons located in the Western District of North Carolina, defendants moved in the district court under FED. R. CIV. P. 12(b)(3) to dismiss on the ground of improper venue. Although the district court did not find it necessary to rule on the motion, the court of appeals stated that the motion should not be granted because of the special venue provision contained in 28 U.S.C. § 1392(a) (1976). 575 F.2d at 467. That provision states that a civil action "not of a local nature, against defendants residing in different districts in the same state, may be brought in any of such districts." 28 U.S.C. § 1392(a) (1976).

293. The complaint charged that defendants' acts and practices amounted to: 1) cruel and unusual punishment in violation of the eighth amendment to the United States Constitution and article I, § 27 of the North Carolina Constitution; 2) denial of access to the courts and access to counsel in violation of the sixth amendment; and 3) denial of due process of law in violation of the fourteenth amendment.

294. Part of the relief sought included requests for the court to: enjoin defendants from accepting new prisoners until minimum constitutional prison standards relating to food, medicine and other matters were met; declare that each prison inmate is entitled to 80 square feet of living space; require defendants to afford prisoners procedural due process with regard to their parole and classification status; appoint a citizens committee to monitor compliance with any order granting relief. 575 F.2d at 463-64.

Suits seeking similar relief have been successful. See *Battle v. Anderson*, 376 F. Supp. 402 (E.D. Okla. 1974), *aff'd*, 564 F.2d 388 (10th Cir. 1978); *Holt v. Sarver*, 309 F. Supp. 362 (E.D. Ark. 1970), *aff'd*, 442 F.2d 304 (8th Cir. 1971). See also Comment, *Confronting the Conditions of Confinement: An Expanded Role for Courts in Prison Reform*, 12 HARV. C.R.-C.L.L. REV. 367, 369 n.12 (1977).

295. 575 F.2d at 463.

296. The court restated the pleading requirements of FED. R. CIV. P. 8 and stated that in testing the sufficiency of a complaint in face of a 12(b)(6) motion "we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." 575 F.2d at 464 (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

297. 575 F.2d at 465. The court appended to the opinion parts of the substantive portions of

noted that the complaint at issue was overbroad²⁹⁸ and that "delineation and definition of the issues"²⁹⁹ would be necessary before the trial could commence, it correctly maintained that summary disposition upon the pleadings was inappropriate under the scheme of the federal rules.³⁰⁰ The case was remanded for further proceedings.

In *Bolding*, the court of appeals joined an increasing number of courts that have rejected the judicially developed hands-off doctrine,³⁰¹ a policy under which courts decline to entertain suits brought by prisoners seeking relief that could entail federal court involvement in the operation of state correctional systems.³⁰² A number of these courts, finding that prison conditions violate prisoners' constitutional rights, have indeed become deeply involved in the operation of state penal systems.³⁰³ This controversial intervention, which has paralleled simi-

the complaint. The complaint contained five substantive allegations, which charged: 1) overcrowding; 2) interference with prisoners' mail; 3) poor conditions in isolation; 4) denial of procedural due process at administrative hearings; and 5) poor general conditions. *Id.* at 467-68. The court made a detailed examination of the complaint and concluded that all of plaintiffs' allegations except the due process charge were sufficiently factual to state cognizable claims. In the opinion, the court detailed the allegations that did satisfy the rule 12(b)(6) requirement; for instance, in support of the isolation charge plaintiffs alleged that they are "not provided with three wholesome . . . meals a day; . . . are not provided with toilet articles necessary to keep up their own personal hygiene; . . . are not provided with adequate shower opportunities; . . . are not provided with clean and sanitary linen; and . . . are not provided with adequate exercise and recreation time." *Id.* at 465.

298. *Id.*

299. *Id.*

300. The court noted that before a trial could begin, it would be necessary to determine whether a class should be certified, whether to sever claims and try them separately, and whether to transfer claims to other North Carolina districts. The court also mentioned that issues could be narrowed or perhaps eliminated through use of other techniques contained in the federal rules—discovery, requests to admit, motions for more definite statements, and pretrial conference. *Id.* at 465-66.

301. Under this doctrine courts refused to exercise jurisdiction or even to consider the allegations of a complaint when confronted with a petition from a prisoner. This reluctance stemmed from the view that the courts did not have the power or responsibility to supervise the management of prison systems. See generally *Banning v. Looney*, 213 F.2d 771 (10th Cir.), *cert. denied*, 348 U.S. 859 (1954); *Garcia v. Steele*, 193 F.2d 276 (8th Cir. 1951); Note, *Beyond the Ken of the Courts: A Critique of Judicial Refusal to Review the Complaints of Convicts*, 72 YALE L.J. 506 (1963).

302. For a history of the recent decline of this doctrine see Comment, *Cruel But Not So Unusual Punishment: The Role of the Federal Judiciary in State Prison Reform*, 7 CUM. L. REV. 31 (1976); Note, *Decency and Fairness: An Emerging Judicial Role in Prison Reform*, 57 VA. L. REV. 841 (1971).

The principle vehicle for prisoner suits is an action under 42 U.S.C. § 1983 (1976).

303. See, e.g., *Pugh v. Loche*, 406 F. Supp. 318 (M.D. Ala. 1976), *aff'd sub nom. Newman v. Alabama*, 559 F.2d 283 (5th Cir. 1977), *cert. denied*, 98 S. Ct. 3144 (1978) (detailed and extensive 11-point plan ordered into effect and human rights committee created to oversee implementation after finding prison conditions violated eighth amendment); *Holt v. Sarver*, 309 F. Supp. 362 (E.D. Ark. 1970), *aff'd*, 442 F.2d 304 (8th Cir. 1971), *aff'd on other grounds sub. nom. Hutto v. Finney*, 437 U.S. 678 (1978) (order for extensive changes in trusty system and barrack and isolation condi-

lar judicial intervention in school desegregation³⁰⁴ and other areas,³⁰⁵ has raised questions of federalism and separation of powers.³⁰⁶ Two recent Supreme Court decisions, *Rizzo v. Goode*³⁰⁷ and *Meachum v. Fanno*,³⁰⁸ can be read to give some support to advocates of the hands-off doctrine, who contend that federal courts overstep their proper role when they interfere in the administration of state institutions. The specter of substantial involvement of the federal courts in the administration of the North Carolina prison system prompted the district court in *Bolding* to refuse even to consider the possibility of class relief and sparked a vehement dissent in the court of appeals.

The dissenting opinion began by indicating that it was in fundamental philosophical disagreement with the majority's "basic holding."³⁰⁹ Citing *Rizzo* and the principles of federalism and state sovereignty, the dissent stated that the very theory of the complaint at issue and the "compass of its allegations and prayers"³¹⁰ made it unentertainable and illegal.³¹¹ The dissent argued that extensive relief of the type prayed for by plaintiffs was simply beyond the legitimate and proper power of a federal court to grant and therefore that a rule 12(b)(6) dismissal was appropriate.³¹²

In contrast, the majority's discussion of this issue began with a re-

tions upon finding violation of eighth and fourteenth amendments). See also Comment, *supra* note 294.

304. Some federal district courts have become deeply involved in the operation of local school boards when they have perceived the need to vindicate constitutional guarantees. See, e.g., *Swann v. Charlotte-Mecklenburg Bd. of Educ.*, 402 U.S. 1 (1971) (affirming district court's extensive desegregation order); *United States v. Missouri*, 515 F.2d 1365 (8th Cir.), cert. denied, 423 U.S. 951 (1975) (affirming district court's order to consolidate school systems).

305. Legislative reapportionment cases also evidence the proclivity of the courts, in remedying constitutional violations, to become involved in matters traditionally thought to be the responsibility of state legislative and executive bodies. See, e.g., *Reynolds v. Sims*, 377 U.S. 533 (1964) (affirming district court's reapportionment order).

306. See, e.g., *Meachum v. Fanno*, 427 U.S. 215 (1976); *Preiser v. Rodriguez*, 411 U.S. 475 (1973).

307. 423 U.S. 362 (1976). In *Rizzo*, the Court reversed a district court's order that mandated substantial changes in the complaint procedures of the Philadelphia Police Department. The Court warned that the principles of federalism militated against broad injunctive orders aimed at executive branches of government "except in the most extraordinary circumstances." *Id.* at 379.

308. 427 U.S. 215 (1976). In *Meachum*, the Court reversed a district court order that voided the transfer, for disciplinary reasons, of inmates from one prison to another because of due process violations in the disciplinary hearings. In the course of finding that the inmates had no constitutionally protected liberty interest, the Court stated that it was not the business of the federal courts to review the "wide spectrum of discretionary actions that traditionally have been the business of prison administrators." *Id.* at 225.

309. 575 F.2d at 468 (Bryan, J., dissenting).

310. *Id.*

311. *Id.*

312. *Id.* at 469.

minder to the district court "of the scope of a proper exercise of its jurisdiction in an appropriate case."³¹³ The court stated that "class relief requiring sweeping changes in a state prison system may still be mandated when the proof requires such relief."³¹⁴ The court specifically concluded that *Rizzo* could not be read to preclude use of broad injunctions to remedy a clear pattern of unconstitutional conduct. This is the correct interpretation of *Rizzo*. The *Rizzo* Court, in reliance upon the district court's own finding that none of the petitioners' constitutional rights had been violated,³¹⁵ voided the injunction at issue because the case "presented no occasion for the District Court to grant equitable relief against petitioners."³¹⁶ Although *Rizzo* and other cases do caution that a court must find a clear violation of a constitutional right before it may become involved in the operation of a state institution,³¹⁷ the *Bolding* court correctly insisted that *Rizzo* and other cases do not cast doubt upon the ability of federal courts to exercise the full range of equitable power when necessary to remedy a constitutional violation.³¹⁸

In examining the allegations contained in the complaint and reversing and remanding the case for further proceedings, the court was careful to refrain from expressing a view on whether plaintiffs could prove any of the facts alleged and, if so, what type of relief, if any, they would be entitled to. The court frankly recognized that there were many troublesome issues to be confronted before the trial could begin.³¹⁹ Yet the court vigorously maintained that, because plaintiffs' complaint did contain allegations sufficiently factual to make it immune to dismissal under rule 12(b)(6), plaintiffs should have been

313. *Id.* at 466.

314. *Id.* This proposition was also maintained by the United States Court of Appeals for the Fifth Circuit in *Newman v. Alabama*, 559 F.2d 283, 288 (5th Cir. 1977).

315. 423 U.S. at 377.

316. *Id.* This makes clear that the holding in *Rizzo* turned on the lack of a constitutional violation.

317. In *Rizzo*, the Court stated that injunctive relief should be granted only in "a clear and plain case," *id.* at 378 (citing *Irwin v. Dixon*, 50 U.S. (9 How.) 10, 33 (1850)) or only in "extraordinary circumstances," *id.* at 379.

318. See *Hite v. Leeke*, 564 F.2d 670, 672 (4th Cir. 1977); *Newman v. Alabama*, 559 F.2d 283, 288 (5th Cir. 1977), *cert. denied*, 98 S. Ct. 3144 (1978). See also Comment, *supra* note 294, at 382-83.

The court specifically stated that it did not consider *Procunier v. Martinez*, 416 U.S. 396 (1974), overruled. In that case the Court stated that "a policy of judicial restraint cannot encompass any failure to take cognizance of valid constitutional claims whether arising in a federal or state institution. When a prison regulation or practice offends a fundamental constitutional guarantee, federal courts will discharge their duty to protect constitutional rights." *Id.* at 405-06.

319. See note 300 *supra*.

given a chance to present their claims and that it was the court's duty to grant any relief ultimately found appropriate on the proof. To the extent that the district court's dismissal was based on its reluctance to undertake this type of case or its unwillingness to grant class relief that might be mandated upon proof of the facts, the dismissal was, it seems, an abdication of judicial responsibility. *Bolding* correctly held that the twenty-nine prisoner plaintiffs are entitled to their day in court.

O. Prosecutor's Duty to Disclose

In *Reddy v. Jones*,³²⁰ the United States Court of Appeals for the Fourth Circuit affirmed the district court's conclusion that a state prosecutor who uses witnesses discovered, kept and provided by federal authorities has no duty to inquire about or disclose inducements made to these witnesses for their favorable testimony if that information is requested by defense counsel. Appellants in *Reddy* were three black civil rights activists, popularly known as the Charlotte 3, convicted in North Carolina state court for the unlawful burning of a stable in 1968.³²¹ The only testimony placing appellants at the barn came from two witnesses who also testified against one of the appellants in a federal trial³²² shortly before the state trial commenced. The witnesses' statements implicating appellants were first made to federal authorities only after the witnesses themselves were arrested in 1970 for violations of the 1968 Gun Control Act. Two years after appellants' convictions in the state trial, independent investigations by news reporters revealed that the witnesses had agreed to testify only after being promised "relocation" money by federal authorities. The amount was not settled upon until after the state trial, when each witness was paid \$4,000, \$1,000 of which was designated as a reward.³²³ Although defense attorneys were aware that the witnesses were being held in protective custody by federal authorities and that immunity from prosecution had been arranged, the financial promises were never made known at the trial, despite appellants' formal requests for information about any promises to witnesses and despite cross-examination of the two witnesses concerning inducements for their testimony.³²⁴

320. 572 F.2d 979 (4th Cir. 1977), *cert. denied*, 99 S. Ct. 126 (1978).

321. *Id.* at 981.

322. *United States v. Grant*, No. 63-71 (E.D.N.C. 1972), *aff'd*, 471 F.2d 648 (4th Cir.), *cert. denied*, 414 U.S. 868 (1973).

323. 572 F.2d at 986 (Butzner, J., dissenting).

324. *Id.*

After appellants had exhausted their state remedies, they applied to federal district court for a writ of habeas corpus, based on a denial of due process in the state prosecutor's failure to disclose these "relocation payments." A panel of the court of appeals affirmed the denial of the writ, rejecting appellants' reliance on a line of decisions finding nondisclosures by prosecutors to be constitutional error.³²⁵ In *Brady v. Maryland*,³²⁶ the United States Supreme Court held the suppression by the prosecutor of material evidence upon request—the confession of defendant's companion in the same case—violated due process "irrespective of the good faith or bad faith of the prosecution."³²⁷ This principle, based primarily on the need to protect the accused's opportunity for a fair trial, was held to require reversal in *Giglio v. United States*,³²⁸ in which a key witness denied that his testimony had been induced, when in fact the Assistant United States Attorney, unknown to the trial prosecutor, had promised the witness an "understanding of leniency" in exchange for his testimony. Viewing the prosecutor's office as an entity including the assistant district attorney, the Supreme Court reversed the defendant's conviction, finding the prosecutor held to knowledge of the assistant district attorney's promises, regardless of the latter's failure to inform his superiors or associates. In *Boone v. Paderick*,³²⁹ a police department detective promised to use his influence to help a witness avoid prosecution if he cooperated. The defendant's attorney was unable to uncover any bargains in his cross-examination of the witness, and the prosecutor, unaware of the detective's promise, credited the witness with altruistic motives for giving testimony, as in *Giglio*. The district court distinguished *Giglio* on the ground that the promise had come from a police officer who did not have authority, rather than from the prosecutor's office. Judge Craven, writing for the Fourth Circuit panel, reversed, finding no merit in this distinction since "the police are also part of the prosecution, and the taint on the trial is no less if they, rather than the State's attorney, were guilty of the nondisclosure."³³⁰

The *Reddy* court concluded that these decisions "stand for the principle that facts bearing upon the credibility of a witness, which if

325. *Id.* at 982; see *Giglio v. United States*, 405 U.S. 150 (1972); *Brady v. Maryland*, 373 U.S. 83 (1963); *Boone v. Paderick*, 541 F.2d 447 (4th Cir. 1976), *cert. denied*, 430 U.S. 959 (1977).

326. 373 U.S. 83 (1963).

327. *Id.* at 87.

328. 405 U.S. 150 (1972).

329. 541 F.2d 447 (4th Cir. 1976).

330. 541 F.2d at 451 (quoting *Barbee v. Walden*, 331 F.2d 842, 846 (4th Cir. 1964)).

not revealed might falsely mislead a jury, must be revealed, whether the knowledge of such facts resides with the police or the prosecutor."³³¹ This principle did not apply in *Reddy*, according to the court, because despite the timing of the payments and the cooperation between state and federal officials, the payments to the witnesses by federal authorities were for the witnesses' testimony at the federal trial only and the state prosecution had known nothing of them. The court concluded that although the state may be "proper insurers of the veracity of their own investigations, they cannot be called upon to foretell the knowledge of others resting in some foreign sphere."³³² The court alternatively held that if a duty to disclose did exist, failure to do so constituted harmless error.³³³

The *Reddy* opinion, however, offered no justification for treating the state prosecutor and the federal authorities who discovered and provided the State's witnesses as separate entities. By refusing to find an implied agency relationship in *Reddy* similar to the agency principle applied in *Giglio*, an unfortunate "double entities" doctrine was created.³³⁴ For example, federal authorities investigating a violation of

331. 572 F.2d at 982.

332. *Id.* at 983.

333. *Id.* Also undisclosed at trial were exculpatory statements by one of the witnesses in a pretrial interview with federal authorities and promises by the state prosecutor to terminate the same witness' 25 year probationary sentence on unrelated charges in exchange for his testimony. The court found no duty to disclose the exculpatory statement, or alternatively that failure to do so was harmless error. *Id.* at 984. The state prosecutor's failure to disclose his promise to terminate the witness' probation was similarly held harmless. *Id.* at 984-85.

The court's alternative holding of harmless error was based on the premise that each piece of undisclosed evidence would have been only cumulative to the evidence already before the jury that tended to impeach the witnesses' credibility. *Id.* at 983. As Judge Butzner's dissent noted,

Under the circumstances, this alternative ruling [of harmless error] is difficult to sustain, and quite properly the panel did not rely solely on it Instead, the panel affirmed on the district judge's "comprehensive opinion," which . . . is primarily based on the theory that non-disclosure did not violate the fourteenth amendment's guarantee of due process.

Id. at 986 (dissenting opinion).

The degree of prejudice necessary to create error requiring reversal or a new trial has been a difficult issue underlying all nondisclosure cases. See generally *United States v. Agurs*, 427 U.S. 97 (1976); Comment, *Prosecutor's Duty to Disclose Reconsidered*, 1976 WASH. U.L.Q. 480.

334. In his dissent to the court's refusal to rehear the case en banc, Judge Butzner noted that the court's decision is basically an extension of the silver platter doctrine. 572 F.2d at 987 (dissenting opinion). The silver platter doctrine would allow federal agents to use evidence obtained as a result of an unconstitutional search or seizure by state officers. The United States Supreme Court in *Elkins v. United States*, 364 U.S. 206 (1960), outlawed this practice on the ground that a person's constitutional rights cannot be stripped from him because state and federal agents cooperate in an investigation and later decide to prosecute in one jurisdiction or another. As the Court stated, "To the victim it mattered not whether his constitutional right has been invaded by a federal agent or by a state officer." *Id.* at 215.

the Hobbs Act³³⁵ could build a case by promising to reward an accomplice. The accomplice could then be turned over to state authorities, who could commence a robbery prosecution on the basis of the informer's testimony. The state trial could proceed without disclosure of the promises so long as the state prosecution did not learn of the federal promises. Absent such disclosure, the state prosecution would naturally be stronger than the federal, in which disclosure of the promises would clearly be required by *Giglio*.

The proposition endorsed by the court that undisclosed promises by a state police officer or associate district attorney may deprive a trial of the fairness required by due process, but that similar promises by federal law enforcement agents do not, seems illogical because the potential for false testimony is just as great and a finding of guilt just as unreliable in the latter as in the former cases. Additionally, fair procedures that protect a defendant constitute an end in themselves, for a fair trial is as important to society as the correct result in a particular case.³³⁶ Arguably this reality was ignored in the *Reddy* decision.

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VII. EVIDENCE

A. Hearsay: Declarations Against Penal Interest

Since 1833, North Carolina courts have excluded as hearsay declarations against penal interest, including third-party extrajudicial confessions to the crime for which a defendant is charged.¹ In the past, North Carolina and the majority of jurisdictions have restricted their declarations against interest exceptions to the hearsay rule to declara-

335. 18 U.S.C. § 1951 (1976).

336. See generally Comment, *supra* note 333.

1. State v. Madden, 292 N.C. 114, 232 S.E.2d 656 (1977); State v. English, 201 N.C. 295, 159 S.E. 318 (1931); State v. May, 15 N.C. 280, 4 Dev. 328 (1833).

tions against pecuniary or proprietary interests.² In *State v. Haywood*,³ however, Chief Justice Sharp reevaluated case law excluding declarations against penal interest in view of the emerging trend toward admission of such evidence⁴ and concluded that declarations against penal interest are admissible, subject to certain conditions designed to preclude false confessions.⁵

In *Haywood*, three defendants indicted for assault with a deadly weapon with intent to kill and inflicting serious injury,⁶ and for robbery

2. MCCORMICK'S HANDBOOK OF THE LAW OF EVIDENCE § 277 (2d ed. 1972) [hereinafter cited as MCCORMICK]; 1 D. STANSBURY'S NORTH CAROLINA EVIDENCE § 147 (H. Brandis rev. 1973) [hereinafter cited as STANSBURY].

3. 295 N.C. 709, 249 S.E.2d 429 (1978).

4. See generally Note, *Declarations Against Penal Interest: Standards of Admissibility Under an Emerging Majority Rule*, 56 BOSTON U.L. REV. 148 (1976). The Note writer observed that seven states (California, Kansas, Nevada, New Jersey, New Mexico, Utah and Wisconsin) and two possessions (Canal Zone and Virgin Islands) have enacted statutes recognizing the admissibility of declarations against penal interest. Fourteen states (Arizona, Hawaii, Idaho, Illinois, Maryland, Minnesota, Missouri, New York, Ohio, Oklahoma, Pennsylvania, South Carolina, Texas and Virginia) have judicially adopted the hearsay rule exception for declarations against penal interest. *Id.* at 149 n.5. In addition, Arkansas and Maine have enacted statutes recognizing this exception, ARK. STAT. ANN. § 28-1001, Rule 804(b)(3) (Supp. 1976); ME. R. EV. 804(b)(3) (1975), and Tennessee has judicially extended the hearsay exception, *Breeden v. Independent Fire Ins. Co.*, 237 Tenn. 769, 530 S.W.2d 769 (1975).

Mr. Justice Holmes, dissenting in *Donnelly v. United States*, 228 U.S. 243, 277-78 (1913), succinctly stated the criticism against restricting the declaration against interest exception to declarations against economic interest:

The rules of evidence in the main are based on experience, logic and common sense, less hampered by history than some parts of the substantive law. . . . [N]o other statement is so much against interest as a confession of murder, it is far more calculated to convince than dying declarations, which would be let in to hang a man

Other criticism of the traditional restriction to economic interests asserts that statements against penal interests generally are no less trustworthy than those exposing the declarant to potential financial losses. See, e.g., *People v. Spriggs*, 60 Cal. 2d 868, 389 P.2d 377, 36 Cal. Rptr. 841 (1964); *People v. Edwards*, 396 Mich. 551, 242 N.W.2d 739 (1976); *Hines v. Commonwealth*, 136 Va. 728, 117 S.E. 843 (1923); Powers, *The North Carolina Hearsay Rule and the Uniform Rules of Evidence*, 34 N.C.L. REV. 171, 197-98 (1956).

Perhaps the most common argument in support of admitting declarations against penal interest is that such statements are no less reliable than those against economic interests. "The desire to avoid criminal liability is as strong as the desire to protect economic interests. It is the determination that the declaration exposes the declarant to a penalty that gives such statements sufficient reliability, not the particular interest that is jeopardized." Note, *supra*, at 152. Moreover, criminal liability often includes pecuniary liability, *id.* at 156 n.46, as in the case of a driver who admits carelessness, exposing himself to both manslaughter charges and a wrongful death claim. Wigmore has advocated extending the hearsay exception to include declarations against penal interest because the traditional rule is an "arbitrary" and "barbarous doctrine." 5 J. WIGMORE, EVIDENCE § 1477 (J. Chadbourn rev. 1974).

5. 295 N.C. at 730, 249 S.E.2d at 442. The *Haywood* decision applies only to third-party confessions offered by the defense to exculpate a criminal defendant. The court was silent about whether such declarations could be used in civil cases or in criminal trials when offered by the prosecution.

6. See N.C. GEN. STAT. § 14-32(a) (Cum. Supp. 1977).

with firearms,⁷ contended that a confession by a fourth defendant (declarant), even though inadmissible against declarant because of a *Miranda* warning violation, should be admitted to exculpate the other defendants because it was a declaration against declarant's penal interest.⁸ Declarant's confession was that he and the other defendants came to North Carolina together and that they stopped at the store where "I [declarant] went in to rob the store but [the prosecuting witness] put up such a fight that I shot him"⁹ The supreme court held that although it would adopt a hearsay exception for declarations against penal interest, the trial court's exclusion of this evidence was not prejudicial to defendants and was in accord with traditional evidentiary rules excluding declarations against penal interest when certain conditions precedent to their admissibility are not present. The court observed that the statement was entirely consistent with the prosecution's theory that "all the defendants were engaged in a joint enterprise, aiding and abetting each other," and affirmed the convictions.¹⁰

While the North Carolina Supreme Court chose to recognize a hearsay exception for declarations against penal interest in *Haywood*, the declaration offered in *Haywood* could not exonerate the proponents because it failed to meet the court's threshold criteria for admitting such declarations.¹¹ The admissibility of declarations against penal interest depends on the trial judge's preliminary finding that such statements reach a certain threshold of trustworthiness.¹² The threshold criteria enumerated in *Haywood*, which expand the traditional requirements for admitting declarations against pecuniary and proprietary interests,¹³ are as follows: The declarant must be unavailable as a witness,

7. *See id.* § 14-87.

8. 295 N.C. at 721, 249 S.E.2d at 436.

9. *Id.* at 716, 249 S.E.2d at 434. Defendant's confession stated:

I came to Clinton from D.C. with James and Linda Watkins, John Brown and Ronald Covington. We stopped at Jackson's Red & White in Clinton. I went in to rob the store but Mr. Jackson put up such a fight that I shot him and ran out of the store. Paul Haywood, 5936 East Capitol Street, Northeast, Washington, D.C. Witness, Lieutenant J.H. Goodwin.

Id.

10. *Id.* at 721, 249 S.E.2d at 436-37.

11. *Id.* at 730, 249 S.E.2d at 442.

12. *Id.*

13. The traditional requirements for admission of a declaration against pecuniary or proprietary interest are stated in 1 STANSBURY, *supra* note 2, at 493-95, as follows:

(1) The declarant must be dead, or for some other reason, unavailable as a witness. (2) The fact stated must have been against the declarant's interest when made, and he must have been conscious that it was so. (3) The declarant must have had competent knowledge of the fact declared. (4) There must have been no probable motive for the declarant to falsify. (5) The interest must be a pecuniary or proprietary (as distinguished from a

have appreciated at the time his confession was made that it had the potential of actually endangering his personal liberty, have had the opportunity to have committed the crime, have had no probable motive to fabricate a confession; the declaration must be a voluntary confession to the crime for which the defendant is on trial and must be inconsistent with the defendant's guilt; and the circumstances surrounding the crime and the declaration must corroborate the confession and must indicate its probable reliability.¹⁴

The formulation of the declarations against interest exception to the hearsay rule approved by the *Haywood* court is essentially a cautious version of the rule laid down by the United States Supreme Court in *Chambers v. Mississippi*.¹⁵ In approving the admission of declara-

penal) one, and it is on this ground that the defendant in a criminal case is not permitted to show the confession of another person.

14. 295 N.C. at 730, 249 S.E.2d at 442. The exact requirements for the admission of declarations against penal interests stated by the court are:

(1) The declarant must be dead; beyond the jurisdiction of the court and the reach of its process; suffering from infirmities of body or mind which preclude his appearance as a witness either by personal presence or by deposition; or exempt by ruling of the court from testifying on the ground of self-incrimination. As a further condition of admissibility, in an appropriate case, the party offering the declaration must show that he has made a good-faith effort to secure the attendance of the declarant.

(2) The declaration must be an admission that the declarant committed the crime for which defendant is on trial, and the admission must be inconsistent with the guilt of the defendant.

(3) The declaration must have had the potential of actually jeopardizing the personal liberty of the declarant at the time it was made and he must have understood the damaging potential of his statement.

(4) The declarant must have been in a position to have committed the crime to which he purportedly confessed.

(5) The declaration must have been voluntary.

(6) There must have been no probable motive for the declarant to falsify at the time he made the incriminating statement.

(7) The facts and circumstances surrounding the commission of the crime and the making of the declaration must corroborate the declaration and indicate the probability of trustworthiness.

Id.

15. 410 U.S. 284 (1973). In *Chambers*, defendant was charged with murder and sought to exculpate himself by offering testimony of witnesses to an extrajudicial confession. Declarant was called as a witness, but renounced his earlier confessions. The Mississippi voucher rule precluded impeachment of one's own witness and the other witnesses were prevented from testifying because the hearsay exception did not extend to penal interests. *Id.* at 285-94. In finding that defendant's fourteenth amendment due process right to present evidence necessary to ensure a fair trial was denied by the exclusion of the confessions, the Court relied heavily on the spontaneity of the confessions and the strong corroborative evidence as indicia of trustworthiness. *Id.* at 300-03. Although *Chambers* did not establish minimum standards for the admissibility of confessions to crime, see generally MCCORMICK, *supra* note 2, § 278 (Supp. 1978), North Carolina's evidentiary requirements enumerated in *Haywood* track the criteria relied upon in *Chambers*. In deciding *Haywood*, the court noted that no constitutional issue was raised, as in *Chambers*, and observed that the holding in *Chambers* was limited because under the facts presented due process demanded admission of the confessions. It seems clear, however, that North Carolina's formulation

tions against penal interest, the *Chambers* Court attributed much of the reliability of proffered extrajudicial confessions to the circumstantial evidence surrounding the making of the statements. Evidence of the surrounding circumstances can enhance the probability that the confessions were actually made and that their contents were not falsified to exculpate the defendant in the trial. Although the *Chambers* rule's corroboration requirement has been criticized¹⁶ and rejected by a small minority of jurisdictions,¹⁷ it is imposed by the majority of jurisdictions admitting extrajudicial confessions¹⁸ and by the federal courts¹⁹ to diminish the risk of fraudulent confessions exculpating the criminal defendant.²⁰

Conditioning the admission of declarations against penal interest on a preliminary determination by the trial court of corroborating facts and circumstances surrounding the commission of the crime and the making of the declaration raises a question regarding the appropriate provinces of the judge and the jury. Arguably, the threshold level of reliability has been met if the declaration has the potential of actually jeopardizing the declarant's penal interest at the time it was made, and the declarant understood this potential and voluntarily made the statement without a probable motive to lie. No greater indicia of trustworthiness is demanded for statements against economic interest.²¹ The traditional suspicions about procured confessions appear insufficiently substantiated to justify such disparate requirements for the admission of statements against penal and economic interests.²² Additionally, that declarant was in a position to have committed the crime to which she or he confessed could be presumed, subject to the introduction of contrary evidence by the State. Corroborating circumstances arguably affect the weight of the evidence rather than its admissibility and

of the declaration against penal interest exception was designed to protect defendants' rights to due process.

16. See Note, *supra* note 4, at 173-78 (contending that corroborating evidence should be weighed by jury in considering credibility).

17. See, e.g., *People v. Spriggs*, 60 Cal. 2d 868, 389 P.2d 377, 36 Cal. Rptr. 841 (1964); *People v. Edwards*, 396 Mich. 551, 242 N.W.2d 739 (1976).

18. See, e.g., *State v. Larsen*, 91 Idaho 42, 415 P.2d 685 (1966); *Hines v. Commonwealth*, 136 Va. 728, 117 S.E. 843 (1923).

19. FED. R. EVID. 804(b)(3). Prior to the effective date of Federal Rule 804(b)(3), a corroboration requirement was approved in *United States v. Goodlow*, 500 F.2d 954 (8th Cir. 1974).

20. Aside from the fraudulent procurement of confessions problem, it is not uncommon for a number of persons to "confess" to highly publicized or spectacular crimes.

21. Compare note 13 *supra* (requirements for declarations against economic interest) with note 14 *supra* (requirements for declarations against penal interest).

22. See 5 J. WIGMORE, *supra* note 4 (discounting fear of procured confessions as "the ancient rusty weapon" preventing justified use of exculpations as well as fraudulent use of confessions).

should be considered by the jury.²³

B. Hearsay: Dying Declarations

In *State v. Stevens*,²⁴ the North Carolina Supreme Court ended any speculation that the admissibility requirements for the dying declaration exception to the hearsay rule were made more restrictive by the 1973 codification in G.S. 8-51.1²⁵ of the common law rule.²⁶ Before enactment of section 8-51.1, dying declarations were admissible in homicide and wrongful death actions²⁷ provided the declarant was "in actual danger of death" at the time of the statement, had "full apprehension of his danger," did actually die,²⁸ and would have been compe-

23. Compare the stringent admission requirements for a declaration against penal interest outlined in *Haywood* with the relatively lenient requirements for an admission implied by silence in *State v. Fewell*, 38 N.C. App. 592, 248 S.E.2d 351 (1978). Generally, if a statement that would naturally be denied if untrue is made in the presence of a person able to hear, understand and respond, his silence or failure to deny it justifies receiving the statement as an admission implied by silence. MCCORMICK, *supra* note 2, § 270. In *Fewell*, a statement accusing defendant of murder was admitted although the witness testified defendant acted "like he was going crazy or something, in some kind of a daze." 38 N.C. App. at 593, 248 S.E.2d at 352 (emphasis added). The court of appeals concluded the statement was properly admitted without mentioning the questionable ability of defendant to hear, understand or respond, and without citing any evidence in support of his mental competence at the time of the accusation. *Id.* at 595-96, 248 S.E.2d at 353.

Indeed, there is no evidence in *Fewell* conflicting with the witness' observation that the accused was in "a daze." See also J. WIGMORE, *supra* note 4, § 1072 ("[I]f on the circumstances it appears that the party was in fact *physically disabled* from answering, his silence of course signifies nothing, and the statement is inadmissible.") The opinion does not indicate whether the trial judge initially determined the competence of defendant and left the question of his ability to understand to the jury. Such an allocation of judge and jury functions is prescribed in *State v. Guffey*, 261 N.C. 322, 325, 134 S.E.2d 619, 622 (1964).

24. 295 N.C. 21, 243 S.E.2d 771 (1978); *accord*, *State v. Penn*, 36 N.C. App. 482, 244 S.E.2d 702 (1978) (follows *Stevens*).

25. N.C. GEN. STAT. § 8-51.1 (Cum. Supp. 1977) provides:

The dying declarations of a deceased person regarding the cause or circumstances of his death shall be admissible in evidence in all civil and criminal trials and other proceedings before courts, administrative agencies and other tribunals to the same extent and for the same purposes that they might have been admissible had the deceased survived and been sworn as a witness in the proceedings, subject to proof that:

(1) *At the time of the making of such declaration the deceased was conscious of approaching death and believed there was no hope of recovery;*

(2) Such declaration was voluntarily made.

Id. (emphasis added).

26. 1 STANSBURY, *supra* note 2, § 146, at 488 n.17 (Supp. 1976).

27. *Id.* § 146.

28. In *State v. Robinson*, 35 N.C. App. 617, 242 S.E.2d 197 (1978), the court of appeals would have been faced with an interesting question under the dying declaration exception had the accused not opened the door to testimony concerning statements made by his assault victim and then failed to object promptly to the hearsay accusations. The court noted that at the time the declarant identified defendant as her assailant, the victim was in actual danger of death and had full apprehension of her danger. This hearsay exception, however, requires that death actually ensue, 1 STANSBURY, *supra* note 2, § 146; the victim in *Robinson* suffered irreversible brain damage and will probably remain in a coma for the rest of her life.

tent to testify if living.²⁹ Section 8-51.1 varies the "full apprehension" formulation of the common law rule to require preliminary proof that the declarant "was conscious of approaching death and believed there was no hope of recovery."³⁰

In two 1976 cases,³¹ the North Carolina Supreme Court observed that the "no hope of recovery" language in section 8-51.1 might be more limiting than existing case law, but declined to reach a conclusion on the matter. During the 1977 fall term, before *Stevens* was decided, the court expressly stated that the statute restricted the former common law exception "since the court must find, in addition to an apprehension of death with death in fact ensuing, that the deceased believed there was no hope of recovery."³²

After reviewing the explanatory statements in the cases prior to enactment of the statute,³³ the *Stevens* court reaffirmed the case law and concluded the statutory terminology did not change those requirements.³⁴ Whether the test is stated as "no hope of recovery" or "full apprehension" of the "actual danger of death," it is the declarant's belief in the imminence of death that is thought to assure the trustworthiness of a dying declaration.³⁵

C. *Privileged Communications: Waiver*

An inflexible application of the concept of waiver of the attorney-

It seems that requiring actual death rather than legitimate unavailability adds nothing to the trustworthiness of the statement or the need for its admission. Since the statute is not limited to homicide prosecutions, an absolute requirement of death is arbitrary. In extending the exception's application to all civil and criminal actions, the legislature must have acted out of belief in the reliability of such statements rather than belief in the necessity of ending secret murders. See *1 STANSBURY, supra*. Obviously, the subsequent fate of the victim cannot be determinative of the trustworthiness of a statement made in the face of imminent death.

29. *State v. Jordan*, 216 N.C. 356, 362, 5 S.E.2d 156, 159 (1939).

30. N.C. GEN. STAT. § 8-51.1 (Cum. Supp. 1977), *quoted in note 25 supra*.

31. *State v. Cousin*, 291 N.C. 413, 419-20, 230 S.E.2d 518, 522 (1976); *State v. Bowden*, 290 N.C. 702, 712, 228 S.E.2d 414, 421 (1976).

32. *State v. Lester*, 294 N.C. 220, 226, 240 S.E.2d 391, 397 (1978).

33. *State v. Jordan*, 216 N.C. 356, 363, 5 S.E.2d 156, 160 (1939) (declarant must have had "full apprehension of his danger" of death); *State v. Dalton*, 206 N.C. 507, 513, 174 S.E. 422, 426 (1934) ("It is not necessary that the declarant should be in the very act of dying; it is enough if he be under the apprehension of impending dissolution."); *State v. Tate*, 161 N.C. 280, 282, 76 S.E. 713, 714 (1912) (it is enough if declarant "believed he was going to die").

34. 295 N.C. at 29, 243 S.E.2d at 776; *accord*, *State v. Penn*, 36 N.C. App. 482, 244 S.E.2d 702 (1978).

35. 5 J. WIGMORE, *supra* note 4, § 1440 ("The essential idea is that the belief should be a positive and absolute one, not limited by doubts or reserves; so that no room is left for the operation of worldly motives . . .").

client privilege led to harsh results for defendant in *State v. Tate*,³⁶ a recent murder and felonious assault prosecution. According to the assault victims' testimony, defendant said he was going to kill them because his lawyer wrote to him and told him that he would receive a ten year sentence for an earlier shooting into the victims' apartment.³⁷ The State called defendant's former attorney as a witness and elicited testimony merely that the attorney had written a letter to defendant three days before the crimes alleged in *Tate*.³⁸ To rebut his former attorney's testimony, defendant sought to establish on cross-examination that although the attorney wrote a letter to him, it contained no statement that defendant would receive ten years for the earlier offense.³⁹ The trial judge, however, ruled out of the jury's presence that such testimony would constitute a waiver of the attorney-client privilege with regard to the contents of the entire letter.⁴⁰ Defendant decided not to cross-examine his former attorney after receiving this ruling.

On appeal the North Carolina Supreme Court approved the trial judge's ruling, rejecting defendant's argument that he should be allowed to show that the letter did not contain the alleged statement without waiving his privilege in respect of the entire contents of the letter.⁴¹ As the *Tate* court noted, it is established law that the substance, but not the existence, of attorney-client communications is privileged from disclosure.⁴² Thus, it was proper to allow the attorney to testify that he had written the letter to defendant three days before the assault and murder. It is also settled law that a client who offers an attorney's testimony regarding the substance of a communication waives the privilege with regard to the entire communication on the matter.⁴³ The concept of waiver stems from the reasoning that when a

36. 294 N.C. 189, 239 S.E.2d 821 (1978). For a discussion of waiver of attorney-client privilege, see generally C. McCORMICK, *supra* note 2, § 93; 1 STANSBURY, *supra* note 2, § 62; 8 J. WIGMORE, *supra* note 4, § 2327.

37. 294 N.C. at 192, 239 S.E.2d at 824.

38. *Id.*

39. *Id.* at 193, 239 S.E.2d at 824. Tate's former lawyer testified in the absence of the jury that the letter did not contain the statement in question.

40. *Id.* at 193, 239 S.E.2d at 824-25.

41. *Id.* at 194, 239 S.E.2d at 825. Justice Exum dissented, stating that he believed it was error to permit the attorney's acknowledgement of the letter without also allowing defendant to establish what the letter did not contain. *Id.* at 200, 239 S.E.2d at 828-29 (dissenting opinion).

42. See generally C. McCORMICK, *supra* note 2, §§ 87-93; 1 STANSBURY, *supra* note 2, § 62; 8 J. WIGMORE, *supra* note 4, § 2309.

43. *Hayes v. Ricard*, 244 N.C. 313, 93 S.E.2d 540 (1956); *State v. Artis*, 227 N.C. 371, 42 S.E.2d 409 (1947); *Jones v. Marble Co.*, 137 N.C. 237, 49 S.E. 94 (1904); McCORMICK, *supra* note 2, § 93; 1 STANSBURY, *supra* note 2, § 62; 8 J. WIGMORE, *supra* note 4, § 2327, at 636.

client's action "touches a certain point of disclosure, fairness requires that his privilege shall cease whether he intended that result or not."⁴⁴ Further examination of the policy underlying the attorney-client privilege suggests, in addition, that waiver is designed to prevent a client from using the privilege as a sword as well as a shield.⁴⁵ Thus, a client may not use partial disclosure when it is advantageous to her or his case to do so, while withholding the damaging information that remains.

The North Carolina cases cited as authority for the waiver concept by the supreme court may be distinguished from *Tate* on their facts. The client in each of the cited cases initiated the testimony regarding the privileged information by testifying himself or by calling the attorney as a witness.⁴⁶ Arguably, the clients in the earlier cases engaged in the deliberate, offensive use of testimony contemplated by the waiver rule, whereas *Tate* reacted defensively in proffering testimony about what the letter did not contain. The policy of the waiver rule would not be undermined if defendant *Tate* had been allowed to dispel the incriminating inference arising from the State's direct examination of his attorney. Defendant sought not to wield the privilege offensively but sought only to preserve the utility of his attorney-client privilege. Under these unusual facts, *Tate*'s silence and reliance on the privilege of nondisclosure might have appeared to the jury to be his acknowledgement and acquiescence in the damaging implications of the attorney's testimony concerning the letter.

D. Character: Impeachment by Prior Acts of Misconduct

On cross-examination, counsel may question any witness concerning specific acts of prior misconduct that tend to discredit the witness.⁴⁷ While most jurisdictions limit such cross-examination to acts of misconduct that are related to the credibility of the witness,⁴⁸ North Carolina courts allow the cross-examiner to bring forth any disparaging facts tending to discredit the testimony of the witness even though those

44. 8 J. WIGMORE, *supra* note 4, § 2327.

45. *Id.*

46. See cases cited note 43 *supra*.

47. 1 STANSBUR', *supra* note 2, §§ 42, 111, at 120-21, 340-42. See also MCCORMICK, *supra* note 2, § 42; 3A J. WIGMORE, *supra* note 4, §§ 981-987.

48. MCCORMICK, *supra* note 2, at § 42. Under FED. R. EVID. 608(b) specific instances of conduct of a witness may be inquired into on cross-examination only if probative of truthfulness. For further discussion of this rule, see Annot., 36 A.L.R. FED. 564 (1978).

facts are only tangentially related to the witness' credibility.⁴⁹ There are, however, several limitations on the state's liberal rule regarding character impeachment: (1) The trial judge has discretionary authority to limit the cross-examiner's scope of inquiry;⁵⁰ (2) the witness may not be asked whether he has been accused, arrested or indicted for an unrelated criminal offense;⁵¹ (3) the cross-examiner is bound by the answer of the witness and may not offer extrinsic evidence in contradiction;⁵² and (4) the questions must be asked in good faith.⁵³

In *State v. Ross*,⁵⁴ defendant was tried and convicted of possession with intent to sell, and of sale and delivery of a controlled substance, methylenedioxy amphetamine (MDA). The State's case rested entirely on the testimony of an undercover police officer who testified that he purchased MDA from Ross at Ross' home on February 2, 1975. De-

49. 1 STANSBURY, *supra* note 2, at § 111; see *State v. Parrish*, 25 N.C. App. 466, 213 S.E.2d 354 (1975) (proper to ask defendant, on trial for driving without license and registration and resisting arrest, whether he had shot a man several years earlier); *State v. McGuinn*, 6 N.C. App. 554, 170 S.E.2d 616 (1969) (in prosecution for murder district attorney allowed to bring out on cross-examination that defendant and his wife had several children before their marriage); *State v. Caldwell*, 25 N.C. App. 269, 212 S.E.2d 669 (1975) (defendant, charged with breaking and entering and larceny, properly questioned about presence of his fiancée in his house at 2:50 a.m. when officers conducted search of premises).

50. 1 STANSBURY, *supra* note 2, § 111, at 341-42; see, e.g., *State v. Williams*, 279 N.C. 663, 675, 185 S.E.2d 174, 181 (1971).

51. *State v. Williams*, 279 N.C. 663, 672, 185 S.E.2d 174, 180 (1971). In a comprehensive opinion by Chief Justice Bobbit the *Williams* court overruled *State v. Maslin* 195 N.C. 537, 143 S.E. 3 (1928), and announced the following rule:

We now hold that, *for purposes of impeachment*, a witness, including the defendant in a criminal case, may *not* be cross-examined as to whether he has been *indicted* or is *under indictment* for a criminal offense other than that for which he is then on trial. . . . In respect of this point, we overrule *State v. Maslin* . . . and decisions in accord with *Maslin*, on the basic ground that an indictment cannot rightly be considered more than an unproved accusation.

A fortiori, we hold that, *for purposes of impeachment*, a witness, including the defendant in a criminal case, may *not* be cross-examined as to whether he has been *accused*, either informally or by affidavit on which a warrant is issued, of a criminal offense unrelated to the case on trial, nor cross-examined as to whether he has been *arrested* for such unrelated criminal offense.

279 N.C. at 672, 185 S.E.2d at 180 (emphasis by court). See generally Annot., 20 A.L.R.2d 1421 (1951).

52. 1 STANSBURY, *supra* note 2, §§ 48, 111, at 138-39, 342; see, e.g., *State v. Cross*, 284 N.C. 174, 200 S.E.2d 27 (1973).

53. 1 STANSBURY, *supra* note 2, at 341. Compare *State v. Hampton*, 294 N.C. 242, 239 S.E.2d 835 (1978) (first degree murder; prosecutor's questions concerning defendant's prior act of breaking and entering and robbery were asked in good faith) with *State v. Phillips*, 240 N.C. 516, 82 S.E.2d 762 (1954) (solicitor's insinuating questioning concerning collateral acts of misconduct was based on supposed fact for which there was no evidence and therefore denied defendant a fair trial).

54. 295 N.C. 488, 246 S.E.2d 780 (1978). The North Carolina Supreme Court granted defendant's petition for discretionary review of the court of appeals holding that there was no error in defendant's trial. 35 N.C. App. 98, 239 S.E.2d 843 (1978).

fendant's evidence tended to show that he was away from his home the night of the alleged purchase.⁵⁵ At trial, the district attorney was permitted to conduct an extensive cross-examination of Ross regarding illegal drugs found in defendant's home during an earlier, unrelated search that had been declared unlawful by the district court.⁵⁶ On appeal the North Carolina Supreme Court focused on defendant's claim that cross-examination concerning articles seized during the prior unlawful search violated the fourth amendment exclusionary rule. The majority opinion concluded that the exclusionary rule did not apply because Ross failed to show that the prior search was declared unlawful for constitutional reasons.⁵⁷ In a strong dissent, however, three members of the court questioned the propriety of the cross-examination permitted by the trial court.⁵⁸

Justice Exum, writing for the dissenters, identified three possible grounds for holding the cross-examination objectionable. First, he argued that defendant was guilty of "misconduct" only if he knowingly possessed the drugs found in his house during the prior unlawful search.⁵⁹ The evidence showed that Ross shared a large house with several other people and was not present when the illegal search was

55. 295 N.C. at 489, 246 S.E.2d at 782. The State's evidence showed that undercover agent R.T. Guerette went to defendant's home in Charlotte on the night of February 27, 1975 and made a previously arranged purchase from Ross of two plastic bags of MDA for \$65. *Id.*

56. *Id.* at 489-90, 246 S.E.2d at 782.

57. *Id.* at 490-92, 246 S.E.2d at 782-84. Defendant cited *Agnello v. United States*, 269 U.S. 20 (1925), and *Walder v. United States*, 347 U.S. 62 (1954), in support of his constitutional argument. In *Agnello*, the United States Supreme Court held questions concerning evidence unconstitutionally seized improper when defendant did not testify concerning the evidence on direct examination and denied knowledge of its existence on cross-examination. 269 U.S. at 35. The *Agnello* rule was refined in *Walder*. The *Walder* Court held that facts pertaining to illegally seized narcotics may be brought out on cross-examination to attack the credibility of a defendant who asserted on direct examination that he had never possessed narcotics. 347 U.S. at 64-65. Defendant in *Ross* argued that the *Agnello-Walder* exclusionary rule was made applicable to the states by *Mapp v. Ohio*, 367 U.S. 643 (1961), and should have been applied on the ground that defendant made no reference to the possession of drugs on direct examination. The *Ross* court, citing several articles and subsequent United States Supreme Court decisions, questioned the continued efficacy of the exclusionary rule and then refused to decide the issue because the record of the trial did not show that the search was declared unlawful for constitutional reasons. 295 N.C. at 491-92, 246 S.E.2d at 783-84. The supreme court hinted, however, that the exclusionary rule would apply when there was a "substantial violation" of the statutory search and seizure procedures set forth in N.C. GEN. STAT. § 15A-974 (Cum. Supp. 1978). 295 N.C. at 492, 246 S.E.2d at 784.

The *Ross* court also addressed defendant's claim that cross-examination of a criminal defendant for impeachment purposes based on prior unrelated convictions and acts of misconduct should be declared unconstitutional. Citing numerous decisions rejecting this argument by both the North Carolina and United States Supreme Courts, the *Ross* majority also rejected this argument. 295 N.C. at 492-93, 246 S.E.2d at 784-85.

58. 295 N.C. at 494-99, 246 S.E.2d at 785-88 (Exum, Lake, J.J., and Sharp, C.J., dissenting).

59. *Id.* at 497-98, 246 S.E.2d at 787 (dissenting opinion).

conducted.⁶⁰ There was no proof that the drugs confiscated during the search were actually the property of defendant Ross.

Second, Justice Exum pointed out that the drug charges used to impeach defendant's testimony were dismissed by the district court.⁶¹ He questioned whether the supreme court "has carried this impeachment rule so far as to permit cross-examination about past criminal conduct for which a defendant has been tried and acquitted,"⁶² citing *State v. Sharratt*⁶³ for the proposition that this may not be done in controlled substance cases.⁶⁴ Examination of the *Sharratt* record shows, however, that the witness was asked whether she had been arrested and indicted, not whether she actually possessed the drugs that were the basis of the indictment.⁶⁵ Moreover, several North Carolina appellate decisions do indeed permit a witness to be impeached by a prior act of misconduct even though the witness was acquitted or the charges against the witness were dismissed.⁶⁶ For instance, in *State v. Parrish*,⁶⁷ no error was found when defendant was asked on cross-examination whether he had killed a man several years earlier even though the prosecutor apparently was aware that defendant had been acquitted of the charge.⁶⁸

60. *Id.* at 494, 246 S.E.2d at 785. Defendant Ross testified that he owned a four bedroom, single family dwelling in which he rented several rooms to help make mortgage payments. Ross' testimony also showed that his job required him to be away from home much of the time. Justice Exum pointed out in a footnote that the presence of the drugs in defendant's house would be evidence of knowing possession, but that defendant was *not* on trial for the earlier possessions even though the district attorney's cross-examination apparently turned the proceeding "into a mini-trial on the question of defendant's guilt of the collateral misconduct." *Id.* at 498 n.1. 246 S.E.2d at 787 n.1.

61. *Id.* at 494, 246 S.E.2d at 785.

62. *Id.* at 499, 246 S.E.2d at 787.

63. 29 N.C. App. 199, 223 S.E.2d 906, *cert. denied*, 290 N.C. 554, 226 S.E.2d 512 (1976).

64. 295 N.C. at 499, 246 S.E.2d at 787 (dissenting opinion).

65. See Record at 47-49, *State v. Sharratt*, 29 N.C. App. 199, 223 S.E.2d 906 (1976). From reading the court of appeals' opinion in *Sharratt*, the exact form of the question asked the witness on cross-examination is not clear. The *Sharratt* decision noted that the drug charges against the witness had been dismissed at the time of the trial, but stated the general rule that a witness may not be cross-examined "regarding an indictment or other accusation of crime, as distinguished from a conviction." 29 N.C. App. at 203, 223 S.E.2d at 908. This ambiguity in the exact form of the cross-examination may account for the *Ross* dissenters' misinterpretation of *Sharratt*.

66. See *State v. Calloway*, 268 N.C. 359, 150 S.E.2d 517 (1966); *State v. Parrish*, 25 N.C. App. 466, 213 S.E.2d 354 (1975).

67. 25 N.C. App. 466, 213 S.E.2d 354 (1975), *discussed in* note 74 *infra*.

68. See Brief for State at 4. Compare *State v. Parrish*, 25 N.C. App. 466, 213 S.E.2d 354 (1975) with *State v. Calloway*, 268 N.C. 359, 150 S.E.2d 517 (1966) (defendant in *Calloway*, on trial for purse snatching, admitted on cross-examination that he had been tried and convicted in nine prior cases of purse snatching; trial court was in error in sustaining solicitor's objection to defendant's attempt to explain that he had obtained a new trial in each case and had on retrial either been acquitted or prosecution had been abandoned).

For an example of a different approach taken by other jurisdictions, see *People v. Sanza*, 37

The third and by far the most forceful argument made by the dissent in *Ross* was that the cross-examination was not conducted in good faith.⁶⁹ The district attorney engaged in detailed questioning concerning specific drugs seized during the prior search that were allegedly the property of defendant Ross. To each inquiry defendant answered that he was not at home on the occasion in question and therefore was unable to admit or deny what might have been found in the house.⁷⁰ In *State v. Williams*,⁷¹ the North Carolina Supreme Court made it clear that questions concerning a witness' prior misconduct must "relate to matters *within the knowledge of the witness*"⁷² The prosecutor in *Ross* obviously was aware that Ross lacked the knowledge necessary to answer the very detailed questions put to him on cross-examination.

A.D.2d 632, 323 N.Y.S.2d 632 (1971) (cross-examination concerning prior acts of misconduct for which witness had been acquitted is *a fortiori* in bad faith).

69. 295 N.C. at 498, 246 S.E.2d at 787 (Exum, J., dissenting).

70. *Id.* at 496-97, 286 S.E.2d at 786-87. The following is a sample of the district attorney's cross-examination in *Ross*:

Q. I'll ask you, sir, if on the third day of January, 1975, if found in your room, pursuant to a search warrant, was 15.67 grams of a green vegetable material, that material being marijuana?

MR. WHITFIELD: OBJECTION as to that question.

COURT: OVERRULED.

DEFENDANT'S EXCEPTION #26.

Q. Was it found in your room, sir?

OBJECTION.

OVERRULED.

DEFENDANT'S EXCEPTION #27.

A. I don't know. To my knowledge, it couldn't have been.

Q. I'll ask you, sir, if on the third day of January, 1975, if found in your room was a zipped-locked bag containing a mottled orange tablet, that tablet analyzed as containing phencyclidine, otherwise known as PCP?

MR. WHITFIELD: OBJECTION.

COURT: OVERRULED.

DEFENDANT'S EXCEPTION #28.

A. No, sir.

Q. Is what you're telling this jury, sir, that you deny it being found there because you don't have any knowledge of it? Is that what you're saying?

OBJECTION: OVERRULED.

DEFENDANT'S EXCEPTION #29.

A. Yes, sir.

Q. So you really have no basis for the denial on what you have stated in this courtroom. Is that right?

OBJECTION: OVERRULED.

DEFENDANT'S EXCEPTION #30.

A. Just the same thing I have said. I wasn't there so I don't know whether it was found in my room or not.

Id. (quoting Record at 114-15).

71. 279 N.C. 663, 185 S.E.2d 174 (1974).

72. *Id.* at 675, 185 S.E.2d at 181 (emphasis by court). For a complete statement of the *Williams* holding, see note 6 *supra*.

The only basis for the cross-examiner's insinuating interrogation was that the illegal drugs were found in a house occupied by defendant and several other people. Because the State's entire case rested on the undercover police officer's testimony that he had made a drug purchase from Ross, the dissenting justices in *Ross* were able to argue persuasively that the State convicted defendant "by trying him, in effect, for certain alleged past offenses of which he had been accused and acquitted."⁷³

Although no new guideline for determining permissible cross-examination referring to prior acts of misconduct was suggested by the *Ross* dissent, it would seem to accord with fundamental fairness to define "good faith" in a manner that would assure the exclusion of questions concerning past acts of misconduct when the cross-examiner has little or no evidence that the witness, in fact, committed wrongful or criminal acts.⁷⁴ In *Watkins v. Foster*⁷⁵ the United States Court of Appeals for the Fourth Circuit, affirming the district court's grant of

73. 295 N.C. at 494, 246 S.E.2d at 785 (Exum, J., dissenting); see note 60 *supra*. In *State v. Phillips*, 240 N.C. 516, 82 S.E.2d 762 (1954), defendant was on trial for obtaining and conspiring to obtain money by false pretenses. The solicitor engaged in a lengthy and highly suggestive cross-examination of defendant, referring to seventeen separate instances of misconduct that had allegedly taken place over a period of several years. The court held that the questions were based on supposed facts of which there was no evidence and granted defendant a new trial. Justice Exum argued that the questions in *Ross* were even more vicious than the ones in *Phillips*. 295 N.C. at 499, 246 S.E.2d at 788 (dissenting opinion). Compare *State v. Phillips*, 240 N.C. 516, 82 S.E.2d 762 (1954), with *State v. Black*, 283 N.C. 344, 196 S.E.2d 225 (1973) (*Phillips* distinguished).

74. Even though the witness was acquitted of a prior charge, however, a good faith inquiry into the act of misconduct should not necessarily be barred. For example, in *State v. Parrish*, 25 N.C. App. 466, 213 S.E.2d 354 (1975), defendant was asked on cross-examination if he had previously killed a man, even though he had been acquitted of the crime. Defendant readily admitted the prior act and on redirect was able to explain the circumstances surrounding the event. The cross-examiner's objective, good faith belief that the witness committed the act should be determinative. A mechanical definition of "good faith" is impractical and should be left to a case by case determination. For example, in *State v. Alford*, 289 N.C. 372, 222 S.E.2d 222 (1976), defendant, on trial for first degree murder, was not prejudiced when the district attorney asked on cross-examination if he had stolen two guns found in his apartment. There was evidence that the guns had been stolen from a hardware store close to defendant's apartment. In a situation such as the one presented by *Ross*, however, in which the cross-examiner has only minimal proof that the act of misconduct was committed by the witness, allowing the questioner to suggest the witness' guilt through detailed cross-examination is not justifiable.

75. 570 F.2d 501 (4th Cir. 1978), affirming 423 F. Supp. 53 (W.D.N.C. 1976). After a prior conviction was overturned and the case was remanded, *State v. Foster*, 282 N.C. 189, 192 S.E.2d 320 (1972), defendant Foster was retried and convicted in February of 1973. The conviction was appealed on several grounds, including improper cross-examination, and the supreme court affirmed. Two justices dissented, arguing that defendant was improperly cross-examined concerning alleged prior acts of misconduct. 284 N.C. 259, 278-84, 200 S.E.2d 782, 796-99 (1973) (Sharpe, J., and Bobbitt, C.J. dissenting). In August 1975 Foster had filed a *pro se* petition for a writ of habeas corpus in the United States District Court for the Western District of North Carolina. Counsel was appointed for defendant and a new petition filed. The district court concluded that reference to six prior acts of misconduct on cross-examination should not have been allowed. Therefore, the writ of habeas corpus was granted and Foster's conviction overturned. *Foster v.*

habeas corpus relief from a North Carolina conviction, seems to have reached just such a result. Defendant Foster was arrested and subsequently indicted for eight separate incidents of burglary and house-breaking.⁷⁶ The State elected to proceed on only one charge, and relied solely on a photographic enlargement of a fingerprint matching Foster's found on a flower pot in one of the burglarized homes.⁷⁷ "Foster's entire defense rested on his credibility."⁷⁸ The defense offered no explanation for the fingerprint but pointed out that defendant was a long-time resident of the area with no prior criminal record and offered the testimony of Foster's wife who stated that the defendant was home in bed when the burglary took place.⁷⁹ During cross-examination, the district attorney, without referring to the pending indictments, asked defendant detailed questions concerning six of the prior burglaries.⁸⁰ Shortly after defendant's conviction all other indictments were dismissed for lack of sufficient evidence.⁸¹

Watkins, 423 F. Supp. 53 (W.D.N.C. 1976). The state appealed the ruling, leading to the *Watkins* opinion by the United States Court of Appeals for the Fourth Circuit.

76. 570 F.2d at 503.

77. *Id.* at 502. The burglary victims were unable to identify Foster and the stolen items were not recovered. *Id.* at 506.

78. *Id.* at 506.

79. *Id.* at 504.

80. *Id.* The following excerpt from the transcript of Foster's cross-examination illustrates the suggestive nature of the questioning:

Q. I will ask you if you didn't break in the residence of James Sinclair at 312 Center Street on October 11, 1971, by going into the front door and reaching up and unscrewing with your fingers a light-bulb in the ceiling?

MR. HICKS: Objection.

COURT: Overruled.

DEFENDANT'S EXCEPTION NO. 24.

Q. Did you or did you not?

A. What you mean "did I"? No, I didn't.

Q. I will ask you if you didn't break into the residence of Lonnie Bell Wallace at 217 South Turner Street? How far is South Turner Street from there on Center Street?

MR. HICKS: Objection.

A. I couldn't tell you.

Q. I will ask you if you didn't break into Lonnie Bell Wallace's house on February 20, 1971, between 6:30 and 11:00 o'clock and by breaking out the center glass window in the front door?

MR. HICKS: Objection.

COURT: Overruled.

DEFENDANT'S EXCEPTION #25.

A. Sure didn't.

Id. (quoting Record at 74-77).

81. At the time of Foster's cross-examination one of the six indictments had already been dismissed. *Id.* at 505. Apparently the North Carolina Supreme Court was not aware of this when they affirmed Foster's conviction. In his dissenting opinion, Chief Justice Bobbitt stated that "the record shows that defendant is under indictment for each of the six criminal offenses to which the cross-examiner's questions relate" *State v. Foster*, 284 N.C. 259, 283, 200 S.E.2d 782, 799

The *Watkins* court, pointing out that the State only had minimal evidence that Foster committed the prior burglaries, held that the cross-examination was not conducted in good faith.⁸² Even though defendant had answered each of the questions in the negative, the insinuating nature of the inquiry undoubtedly left an indelible mark on the minds of the jurors.⁸³ The court of appeals used language similar to that of the dissent in *Ross* when it concluded that defendant Foster "was tried not only on the evidence, but also on the detailed 'facts' recounted in the prosecutor's questions"⁸⁴ The *Watkins* court did note, however, that had the State presented overwhelming independent evidence of defendant's guilt the error would have been harmless.⁸⁵ The only factor distinguishing *Watkins* from *Ross* is that the defendant in *Watkins* was under indictment for the prior acts of misconduct, whereas the defendant in *Ross* had been acquitted of the

(1973) (dissenting opinion). It is doubtful that knowledge of the dismissed indictment would have changed the view of the majority, which ruled summarily that the cross-examination was proper. *Id.* at 275, 200 S.E.2d at 794.

82. 570 F.2d at 505-06. Although not referring specifically to the good faith issue, the dissenting justices in *State v. Foster*, reached an identical conclusion after reviewing the same record. Chief Justice Bobbitt focused on the problem created by allowing this type of cross-examination:

Under the circumstances, the asking of these six questions by the State's counsel was highly prejudicial to defendant in that it tended to destroy by inference and suspicion the otherwise unimpeached evidence as to his alibi and as to his good character. The asking of these questions gave the impression that the State's counsel had knowledge of evidential facts sufficient to support these insinuations. The record tends to negate rather than to support the view that he had such knowledge.

284 N.C. 259, 283-84, 200 S.E.2d 782, 799 (dissenting opinion).

83. "Foster's denial of the prosecutor's insinuations should have left his credibility intact but in actuality could not erase the blemish on his character which had been left in each juror's mind." 570 F.2d at 506.

84. *Id.* at 507.

85. *Id.* at 506 n.6.

In *State v. Thompson*, 37 N.C. App. 651, 247 S.E.2d 235 (1978), defendant was tried and convicted of armed robbery. Several persons observed the robbery and were able positively to identify defendant. On appeal Thompson, citing *Watkins*, argued that the trial court erred in permitting the State to impeach him by asking about other robberies for which he was under indictment. The North Carolina Court of Appeals rejected this argument, pointing out that "the State's case against Foster consisted solely of fingerprint evidence; the evidence against defendant Thompson is not nearly so sparse." *Id.* at 660, 247 S.E.2d at 240.

Judge Widener, dissenting in *Watkins*, pointed out that the majority seemed to reach its determination of bad faith because the indictments on which the cross-examination was premised were dismissed for lack of sufficient evidence. He concluded that, henceforth, impeachment by prior acts of misconduct will only be permissible in the Fourth Circuit when the cross-examiner possesses evidence sufficient to prove the prior acts beyond a reasonable doubt. 570 F.2d at 507-08 (dissenting opinion). While this argument may be technically correct, it should not, as Widener suggests, unduly limit the ability of the cross-examiner to impeach the witness. For example, in *Watkins* the State based its entire case on one fingerprint of defendant found in the home of a burglary victim. If the State had possessed a similar quantum of proof in connection with any of the indictments that were later dismissed, the majority view would apparently have found such evidence sufficient to permit good faith cross-examination.

misconduct. In both cases the cross-examination presumably had a detrimental effect on the defendant's credibility. The *Watkins* court took the sounder course in prohibiting impeachment by prior acts of misconduct for which there was only a minimal factual basis.

E. Refreshing Recollection

As a general rule, a witness who is unable to recall a fact about which he or she is questioned may refer to a writing to refresh his recollection, provided that the writing is made available to opposing counsel for inspection.⁸⁶ A witness who refreshes his memory before trial need not produce in court the writing used for that purpose.⁸⁷ In *State v. McQueen*,⁸⁸ the supreme court held that a witness' testimony concerning her present recollection of past events was not rendered incompetent when her memory was refreshed prior to trial by hypnosis.⁸⁹ Although *McQueen* is a case of first impression in North Carolina, the court's decision is in accord with decisions from other jurisdictions.⁹⁰

86. See 1 STANSBURY, *supra* note 2, § 32. A writing is not the only instrument that may be used to refresh memory. In *State v. Peacock*, 236 N.C. 137, 139, 72 S.E.2d 612, 615, the supreme court, discussing the witness' use of memoranda to refresh memory while testifying, quoted with approval the following passage from *Jewett v. United States*, 15 F.2d 955, 956 (9th Cir. 1926):

[I]t is quite immaterial by what means the memory is quickened; it may be a song, or a face, or a newspaper item, or a writing of some character. It is sufficient that by some mental operation, however mysterious, the memory is stimulated to recall the event, for when so set in motion it functions quite independently of the actuating cause.

The evidence, of course, consists of the witness' testimony, not the document used to refresh recollection. *State v. Greenlee*, 22 N.C. App. 489, 206 S.E.2d 753, *appeal dismissed*, 285 N.C. 761, 209 S.E.2d 285, *cert. denied*, 286 N.C. 339, 210 S.E.2d 59 (1974), *cert. denied*, 421 U.S. 969 (1975). The document may, however, be introduced into evidence by the adverse party or may be used as an aid in cross-examining the refreshed witness. See 1 STANSBURY, *supra* note 2, § 32. See generally MCCORMICK, *supra* note 2, § 9.

87. See, e.g., *Star Mfg. Co. v. Atlantic Coast Line R.R.*, 222 N.C. 330, 23 S.E.2d 32 (1942).

88. 295 N.C. 96, 244 S.E.2d 414 (1978).

89. *Id.* at 119, 244 S.E.2d at 427. The opinion, however, expressly limited hypnosis to use as an aid in refreshing recollection prior to trial. The court noted that the witness was not under hypnosis during trial, that no question was raised about the admissibility of pretrial statements made under hypnosis, and that the State did not attempt to introduce testimony of the hypnotist concerning statements made by the witness while in a hypnotic trance. Accordingly, the court expressed no opinion on these issues. *Id.* at 119, 122, 244 S.E.2d at 427, 429. In dictum, the *McQueen* court also approved of the use of psychiatric or other medical treatment as a device for refreshing memory. *Id.* at 120, 244 S.E.2d at 428.

Courts in other jurisdictions have refused to admit pretrial statements made under hypnosis, see, e.g., *State v. Harris*, 241 Or. 224, 405 P.2d 492 (1965), and have held that a hypnotist may not testify concerning what his subject said while under hypnosis, see, e.g., *State v. Pierce*, 263 S.C. 23, 207 S.E.2d 414 (1974).

90. The *McQueen* court cited with approval the four leading cases in this area. 295 N.C. at 120-21, 244 S.E.2d at 428-29 (citing *Kline v. Ford Motor Co.*, 523 F.2d 1067 (9th Cir. 1975); *Wyller v. Fairchild Hiller Corp.*, 503 F.2d 506 (9th Cir. 1974); *Harding v. State*, 5 Md. App. 230, 246 A.2d 302 (1968); *State v. Jorgensen*, 8 Or. App. 1, 492 P.2d 312 (1971)).

In *McQueen*, witness Kiser and defendant McQueen were involved in a double murder in June 1972.⁹¹ In August 1972 Kiser voluntarily surrendered and, in exchange for a grant of prosecutorial immunity, gave a statement to police implicating McQueen.⁹² In September 1977, several weeks before defendant was brought to trial in North Carolina, Kiser asked to be hypnotized to aid her memory of the events surrounding the murders.⁹³ Kiser's testimony at trial, based on her memory as revived by the hypnosis, was inconsistent with the statement she gave to police two months after the crime was committed, and was more prejudicial to defendant.⁹⁴ McQueen's counsel argued that Kiser's testimony was based on post-hypnotic suggestion rather than on her present memory of past events, and that Kiser's testimony should have been entirely excluded.⁹⁵ The *McQueen* court rejected this argument, citing several cases that have held that a witness whose memory has been refreshed by hypnosis is able to testify from present recollection of past events.⁹⁶

In legal effect, the use of hypnosis to revive memory is no different from the use of more conventional means, such as by reading a document.⁹⁷ As the *McQueen* court correctly noted, that a person was hypnotized prior to trial should bear upon that person's credibility, which is a factual determination for the jury to make in most cases, but should not bear upon the witness' competence to testify, which is a legal determination for the judge to make.⁹⁸ McCormick refers to the hypnotized person as "ultrasuggestible,"⁹⁹ and warns that the use of any item to

91. 295 N.C. at 99, 244 S.E.2d at 416.

92. *Id.* at 101, 244 S.E.2d at 417.

93. *Id.*

94. In her statement to the police in August 1972, Kiser stated that McQueen committed the murders inside the victim's home while Kiser was outside the house. After Kiser's memory was refreshed with the aid of hypnosis, she testified at trial that she was actually present and that she saw McQueen commit the murders. *See* Record at 65-67; Brief for Defendant at 24-25.

95. Brief for Defendant at 28.

96. 295 N.C. at 120-21, 244 S.E.2d at 428-29 (citing *Kline v. Ford Motor Co.*, 523 F.2d 1067 (9th Cir. 1975); *Wyller v. Fairchild Hiller Corp.*, 503 F.2d 506 (9th Cir. 1974); *Harding v. State*, 5 Md. App. 230, 246 A.2d 302 (1968); *State v. Jorgensen*, 8 Or. App. 1, 492 P.2d 312 (1971)). In *Harding v. State*, a detailed opinion explaining the theory behind hypnotic suggestion, the Court of Special Appeals of Maryland pointed out that modern medical science has recognized that hypnosis can be helpful in restoring memory of past events. 5 Md. App. at —, 246 A.2d at 311-12.

97. The United States Court of Appeals for the Ninth Circuit, in *Kline v. Ford Motor Co.*, 523 F.2d 1067 (9th Cir. 1975), noted that "[a]lthough the device by which recollection was refreshed is unusual, in legal effect [the] situation is not different from that of a witness who claims that his recollection of an event that he could not earlier remember was revived when he thereafter read a particular document." *Id.* at 1069-70.

98. 295 N.C. at 119, 244 S.E.2d at 427.

99. MCCORMICK, *supra* note 2, § 208, at 510.

refresh memory creates a very real danger that the witness "will 'remember' something that never happened."¹⁰⁰ The basic safeguards against abuse in this area, which include the trial judge's power to exclude testimony when he determines that memory was not actually refreshed,¹⁰¹ and the adverse party's right to cross-examine the witness,¹⁰² should provide adequate protection when hypnosis is used to refresh recollection.

F. Jury Arguments

An attorney, in presenting his case to the jury, has the right to argue every aspect of the case supported by evidence in the record, including the reasonable inferences that can be drawn from that evidence.¹⁰³ He may also argue the applicable legal principles involved in the case.¹⁰⁴ Counsel may not, however, "travel outside the record" and inject into [the] argument" his personal views and beliefs.¹⁰⁵ In *Currituck Grain Inc. v. Powell*,¹⁰⁶ the North Carolina Court of Appeals, making a logical extension of this rule, held that it was error for the trial court to allow an attorney to personally vouch for the credibility of

100. *Id.* § 9, at 16-19.

101. *See State v. Collins*, 22 N.C. App. 590, 207 S.E.2d 278, *cert. denied*, 285 N.C. 760, 209 S.E.2d 284 (1974) (witness may testify from refreshed memory "if, after reading the document, he is able to remember the events . . ."). *Id.* at 595, 207 S.E.2d at 281 (emphasis added)). Even where the witness' memory is not revived, the document itself may be read to the jury and introduced as evidence if the requirements of "past recollection recorded" are met. *See McCORMICK*, *supra* note 2, § 9, at 299-303; 1 STANSBURY, *supra* note 2, § 33.

102. STANSBURY, *supra* note 2, § 32, at 87. A question left unanswered by the *McQueen* opinion is whether the availability of the hypnotist for cross-examination is a prerequisite to the admission of testimony by a witness whose memory has been refreshed by hypnosis. The court pointed out that defendant had access to a tape recording of the entire hypnosis procedure and that the hypnotist was available to testify, though he was not called by either party. 295 N.C. at 120, 244 S.E.2d at 428. In each of the cases cited by the *McQueen* court in support of its decision, *see* note 52 *supra*, the hypnotist testified concerning the procedure. In *Wyller v. Fairchild Hiller Corp.*, 503 F.2d 506 (9th Cir. 1974), the court stated that the adverse part was entitled to challenge the reliability of the hypnosis procedure through cross-examination of the hypnotist. *Id.* at 509-10.

103. *See, e.g., Crutcher v. Noel*, 284 N.C. 568, 201 S.E.2d 855 (1974); *Lamborn & Co. v. Hollingsworth & Hatch*, 195 N.C. 350, 142 S.E. 19 (1928). In *State v. McKenna*, 289 N.C. 668, 224 S.E.2d 537 (1976), the supreme court pointed out that the scope of argument to the jury is within the sound discretion of the trial judge. His ruling will only be disturbed when there is prejudicial error. *Id.* at 687, 224 S.E.2d at 550. Also, in *State v. Alford*, 289 N.C. 372, 222 S.E.2d 222 (1976), the court noted that wide latitude should be given counsel in arguing his case to the jury. *Id.* at 384, 222 S.E.2d at 230.

104. N.C. GEN. STAT. § 84-14 (1975); *see, e.g., State v. McMorris*, 290 N.C. 286, 225 S.E.2d 553 (1976) (court emphasized that law argued must be applicable to facts of case).

105. *Cuthrell v. Greene*, 229 N.C. 475, 50 S.E.2d 525 (1948).

106. 38 N.C. App. 7, 246 S.E.2d 853 (1978).

his witness during closing argument.¹⁰⁷

In a case of first impression,¹⁰⁸ the *Currituck Grain* court held that counsel's reference to his acquaintance with plaintiff's witness was, in effect, testimony by the attorney about the witness' credibility.¹⁰⁹ Referring to attacks made on the memory and truthfulness of the witness during the trial,¹¹⁰ plaintiff's counsel, over defendant's objection, stated: "[Plaintiff's witness] is a man of honesty and integrity and he is not going to . . . commit perjury from the witness stand under oath. I have known him for a long time and I know he is not a person who is able to do that."¹¹¹

As courts in numerous other jurisdictions have pointed out, to permit such conduct allows the attorney to bolster the credibility of the witness through unsworn testimony that is not subject to cross-examination.¹¹² Additionally, when the trial judge overrules an objection and permits counsel to argue facts outside the evidence presented in the case, the judge, in effect, highlights the error by putting his stamp of approval on the argument.¹¹³ The *Currituck Grain* court properly recognized the great potential for prejudice when an attorney is allowed to vouch for the credibility of his witness in his closing argument.

107. Plaintiff's counsel's improper closing statement regarding his client's veracity coupled with plaintiff's witness' expression of an opinion on the ultimate issue in the case, *see* text accompanying notes 114-131 *infra*, resulted in the *Currituck Grain* court ordering a new trial for defendant. *Id.* at 12, 246 S.E.2d at 856.

108. In *State v. Monk*, 291 N.C. 37, 229 S.E.2d 163 (1976), the North Carolina Supreme Court faced a somewhat similar problem but did not directly rule on the issue. The district attorney in *Monk* stated that he had known the State's witness for 15 years and further implied that he personally felt the witness was telling the truth. The *Monk* court noted its disapproval of the argument but found no prejudicial error and did not elaborate on the issue.

109. 38 N.C. App. at 12, 246 S.E.2d at 856. In light of the general rule that counsel may refer to any evidence contained in the record during his closing argument, he should also be able to comment on the credibility of a witness if his remarks are based on evidence introduced in the case. *See State v. Gauger*, 200 Kan. 515, 438 P.2d 455 (1968).

110. The North Carolina Supreme Court has held that counsel, by making improper remarks to the jury, may invite retaliatory argument by opposing counsel. *State v. McCall*, 289 N.C. 512, 223 S.E.2d 303 (1976). In *McCall*, defense counsel vehemently attacked the credibility of several of the State's witnesses, referring to one of them as a liar. The district attorney responded with an abrasive attack on defendant's counsel and also made several general comments concerning the good character of the State's witnesses. The supreme court found no error, holding that the remarks of the defense counsel opened the door for the district attorney's argument. The attack on plaintiff's witness in *Currituck Grain* took place during cross-examination rather than defense counsel's closing argument. 38 N.C. App. at 12, 246 S.E.2d at 856.

111. 38 N.C. App. at 11, 246 S.E.2d at 856. The attorney also stated that the witness was known throughout the county for his honesty and integrity and referred to his election to the Currituck County School Board. *Id.*

112. *See* Annot., 81 A.L.R.2d 1240 (1962); 75 AM. JUR. 2d *Trial* §§ 305, 306 (1974).

113. *See Crutcher v. Noel*, 284 N.C. 568, 201 S.E.2d 855 (1974).

G. Opinion

In *Currituck Grain Inc. v. Powell*,¹¹⁴ the North Carolina Court of Appeals also restated the rule that a witness should not be allowed to express an opinion on the ultimate issue in the case.¹¹⁵ This evidentiary principle has been severely criticized over the past thirty-five years¹¹⁶ and has been abandoned by many state courts.¹¹⁷ As Professor Brandis suggests, the rule "has produced only confusion and unpredictability, and [should] be completely revised or definitely repudiated by the Court."¹¹⁸

The traditional justification for the rule is that the witness would be invading the province of the jury if allowed to express an opinion on the exact question at issue.¹¹⁹ Courts adhering to the rule are concerned that the members of the jury will substitute the opinion of the witness for their own. It is often difficult to determine, however, whether the opinion expressed actually goes to the ultimate issue in the case.¹²⁰ Also, the many recognized exceptions to the rule have tended to make its application even more confusing.¹²¹ Moreover, abolition of

114. 38 N.C. App. 7, 246 S.E.2d 853 (1978).

115. *Id.* at 11, 246 S.E.2d at 856. This rule is generally assumed to apply to expert as well as lay opinions. Application of the rule may be relaxed, however, when expert testimony is involved. See 1 STANSBURY, *supra* note 2, § 126, at 393 n.33.

116. See MCCORMICK, *supra* note 2, § 12, at 27. McCormick points out that the trend began with the Iowa Supreme Court's decision in *Grismore v. Consolidated Prods. Co.*, 232 Iowa 328, 5 N.W.2d 646 (1942). The *Grismore* court held that, as long as the matter at issue is one in which opinion testimony is proper, the witness' opinion should be admitted "even though it passes upon a controlling fact, or the ultimate fact which the jury must determine." *Id.* at 344, 5 N.W.2d at 655-56.

117. See MCCORMICK, *supra* note 2, § 12, at 27. McCormick indicates that a majority of state courts have discarded the rule in the area of expert testimony and that at least a few courts have allowed ultimate issue opinion by lay witnesses. *Id.* Under FED. R. EVID. 704, an opinion, otherwise admissible, "is not objectionable because it embraces an ultimate issue to be decided by the trier of fact."

118. 1 STANSBURY, *supra* note 2, § 126, at 393. For a discussion of early North Carolina cases illustrating the problems created by the rule, see Note, 16 N.C.L. REV. 180 (1938). See also 7 WIGMORE, *supra* note 4, §§ 1920, 1921 (referring to rule as empty rhetoric).

119. See, e.g., *Starkey Paint Co. v. Springfield Life Ins. Co.*, 24 N.C. App. 507, 211 S.E.2d 498 (1975) (in action on insurance policy in which defendant insurer denied coverage, contending that death was by suicide, trial court erred in admitting testimony by witness who testified that, upon seeing insured's body, he stated "he has committed suicide").

120. E.g., *State v. Atkinson*, 278 N.C. 168, 179 S.E.2d 410 (1971) (ultimate issue was whether victim had been raped; State's pathologist allowed to express his opinion that victim had been penetrated and that injuries could have been caused by a male organ); *Triad Constructors, Inc. v. Morris*, 25 N.C. App. 647, 214 S.E.2d 209 (1975) (in counterclaim action for breach of contract in which defendant alleged that plaintiff failed to properly elevate floor of building, defendant's expert witness was allowed to testify that elevation of floor by 5 3/4 inches would have prevented drainage problems).

121. 1 STANSBURY, *supra* note 2, §§ 126-129, at 134, 198-99. Stansbury points out that exceptions to the rule are recognized when the following questions are at issue: (1) mental capacity or

the rule would not, as some decisions suggest, open the door to opinions that merely tell the jury how to decide the case.¹²² The guidelines applicable to the admission of opinion evidence in general would provide adequate safeguards. First, opinion testimony on any issue is inadmissible when the witness can relate the facts in a manner that the jury can understand or the jury is as well-qualified as the witness to draw a conclusion from the facts.¹²³ A witness' opinion in either situation is clearly of no help to the jury in deciding the case.¹²⁴ Second, opinions on questions of law are always excluded.¹²⁵ Even courts permitting opinion on the ultimate issue prohibit questions that call for the witness to give a legal opinion.¹²⁶ Finally, the basis for a witness' opinion is always subject to attack during cross-examination.¹²⁷

In *Currituck Grain*, the ultimate issue was whether defendant came within the Uniform Commercial Code's (UCC) definition of "merchant."¹²⁸ A merchant is defined in the UCC as one who has knowledge or skill peculiar to the transaction in question.¹²⁹ On direct examination plaintiff's chief witness was allowed to testify over objection that, in his opinion, defendant had the special knowledge and skill

condition; (2) habits of temperance or intemperance; (3) solvency or insolvency; (4) identity; (5) handwriting; and (6) value. *Id.* § 126, at 395. Also, numerous cases have avoided the issue by treating the witness' testimony as a shorthand statement of fact rather than an opinion. *See, e.g.,* Tarkington v. Rock Hill Printing & Finishing Co., 230 N.C. 354, 53 S.E.2d 269 (1949) (testimony of witness characterized as shorthand statement of fact rather than opinion and therefore did not invade province of jury); *Morris v. Lambeth*, 203 N.C. 695, 166 S.E. 790 (1932) (plaintiff alleged property damage caused by negligent construction of dam; defendant's witness allowed to state that, in his opinion, dam broke due to some "manner of explosion").

122. *See, e.g.,* *Ponder v. Cobb*, 257 N.C. 281, 126 S.E.2d 67 (1962).

123. If either condition is absent, the opinion should be admitted. The reference in the second condition to a witness with knowledge superior to the jury refers to testimony by an expert. 1 STANSBURY, *supra* note 2, § 124, at 388-89; *see, e.g.,* *Davis v. Cahoon*, 11 N.C. App. 395, 181 S.E.2d 229 (1971).

124. *See* 1 STANSBURY, *supra* note 2, § 123, at 386. The advisory committee note to FED. R. EVID. 704, discussed in note 117 *supra*, points out that opinions that merely tell the jury what result to reach should be excluded under FED. R. EVID. 403 as evidence that wastes time.

125. *See, e.g.,* *State v. Sawyer*, 26 N.C. App. 728, 217 S.E.2d 116, *cert. denied*, 288 N.C. 395, 218 S.E.2d 469 (1975) (court properly excluded question put to policeman on cross-examination concerning his duty under law at issue); *Brooks & Brooks, Ltd. v. Easton's Culligan Water Conditioning*, 28 N.C. App. 143, 220 S.E.2d 147 (1975) (question concerning whether offer was "amended" held not to require expression of legal opinion).

126. *See* MCCORMICK, *supra* note 2, § 12, at 28-29. McCormick points out that when the issue is one's capacity to make a will "a court taking the view that there may be opinion upon an ultimate issue would approve a question, 'Did X have mental capacity sufficient to understand the nature and effect of his will?' but would frown on the question, 'Did X have sufficient mental capacity to make a will?'" *Id.* § 12, at 29.

127. *See* 1 STANSBURY, *supra* note 2, § 35, at 103-08.

128. 38 N.C. App. at 8-9, 246 S.E.2d at 855.

129. N.C. GEN. STAT. § 25-2-104(1) (1965).

necessary to sell corn and soybean "futures."¹³⁰ At no time was the witness asked if he believed defendant was a "merchant" when the transaction in question took place.¹³¹ Nevertheless, the court held that the form of the questions¹³² called for the witness to answer the very legal question at issue in the case. This seems to be a very questionable result, especially in light of defendant's opportunity to expose any weakness in the basis for plaintiff's witness' opinion on cross-examination. The North Carolina courts should examine the experience of jurisdictions that have abandoned the rule prohibiting "ultimate issue" opinion. Application of the basic principles regarding opinion evidence would appear to provide adequate assurance that the province of the jury is not infringed by such evidence.

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130. *Id.* at 10-11, 246 S.E.2d at 855.

131. Defendant objected to the following questions:

Q. And did he hold himself out as having knowledge by his occupation as a farmer that he knew what he was talking about when he was negotiating the sale with you?

MR. TRIMPI: OBJECTION.

THE COURT: OVERRULED.

WITNESS: I certainly felt like he knew what he was talking about.

BY MR. BRUMSEY:

Q. Was his conversation with you in your opinion knowledgeable?

MR. TRIMPI: OBJECTION.

THE COURT: OVERRULED.

WITNESS: Yes.

Id. at 10-11, 246 S.E.2d at 855 (quoting Record at 24).

132. *Id.* at 11, 246 S.E.2d at 855-56.

VIII. FAMILY LAW¹

A. Child Custody and Support

1. Termination of Parental Rights

The court of appeals in *In re Dinsmore*² denied the Guilford County Department of Social Services' request to terminate respondent's parental rights over her child, even though respondent never initiated plans for the return of the child during the three years the child was in custody of the department,³ or responded affirmatively to attempts by the department to effect the child's return during that time.⁴ In reaching its decision, the court ignored the best interests of the child⁵ and narrowly construed former G.S. 7A-288(1) and (3),⁶ the statutory

1. Two 1978 cases that are treated elsewhere involved significant family law issues. Important conflict of laws issues were resolved by the court of appeals in *Vincent v. Vincent*, 38 N.C. App. 50, 248 S.E.2d 410 (1978). The *Vincent* court held that a sister state that has personal jurisdiction over both spouses in a divorce action may terminate a prior North Carolina alimony decree, and that a sister state may, regardless of whether it has personal jurisdiction over both parties, modify a prior North Carolina alimony decree to the same extent that a North Carolina court may do so. The court further established that the obligation to make alimony payments decreed by a North Carolina court, but properly terminated by a sister state, is extinguished at the time the foreign decree terminating the payments is entered. For a discussion of *Vincent*, see this Survey, *Constitutional Law: Full Faith and Credit*.

The supreme court in *Gardner v. Gardner*, 294 N.C. 172, 240 S.E.2d 399 (1978), considered the important procedural question of the applicability of the compulsory counterclaim provisions of N.C.R. Civ. P. 13(a) to divorce actions. The court held that rule 13(a) applies in divorce actions as it does in other civil actions, but that a claim arising out of a marital dispute that forms the basis of an action filed by one spouse can be prosecuted after final judgment has been entered in that spouse's prior action and is not barred by rule 13(a) so long as proceedings in the second spouse's claim were not instituted during the pendency of the other spouse's action. For an extensive discussion of *Gardner*, see Note, *New Rules for an Old Game, North Carolina Compulsory Counterclaim Provision Applies in Divorce Actions*, 57 N.C.L. REV. 439 (1979).

2. 36 N.C. App. 720, 245 S.E.2d 386 (1978).

3. The child had been in custody of the Department of Social Services since December 27, 1973. The action by the department to terminate the parents' rights to the child was instituted November 19, 1976. *Id.* at 721, 245 S.E.2d at 386.

4. Since respondent's child has been in custody of the department, the department has tried unsuccessfully to help respondent overcome her chronic alcoholism and has counseled respondent on the actions she must take to regain custody of the child. Against the advice of the department, respondent continues to live with a man who prevents her child from visiting her. *Id.* at 721-23, 245 S.E.2d at 386-88.

5. The court never discussed whether termination of respondent's parental rights would be in the best interest of the child, even though the "best interest" standard guides courts in custody disputes and adoption proceedings. See N.C. GEN. STAT. § 50-13.2(a) (Supp. 1977); *id.* § 48-1(3) (1976).

6. These provisions provided:

Termination of parental rights.—In cases where the court has adjudicated a child to be neglected or dependent, the court shall have authority to enter an order which terminates the parental rights with respect to such child if the court finds any one of the following:

(1) That the parent has abandoned the child for six consecutive months prior to the special hearing in which termination of parental rights is considered or that

provisions governing termination of parental rights under which the case arose. The court equated abandonment under former G.S. 7A-288(1), which was a condition for termination of parental rights, to wilfull abandonment under G.S. 48-2,⁷ which governs adoption of abandoned children, and applied the same criminal wilfulness standard⁸ used in interpreting G.S. 48-2 to both G.S. 7A-288(1) and (3). Applying these circumscribed definitions of abandon and wilful, the court found that respondent had neither abandoned her child under G.S. 7A-288(1) nor wilfully failed to contribute adequate financial support to her child under G.S. 7A-288(3).⁹

Although discussion of the merits of the *Dinsmore* decision has been mooted by the replacement of former G.S. 7A-288 with G.S. chapter 7A, article 24B—Termination of Parental Rights,¹⁰ this decision is instructive in that it reveals an unwillingness by the court of

a child is an abandoned child as defined by Chapter 48 of the General Statutes entitled "Adoption of Minors."

- (3) That the parent has willfully failed to contribute adequate financial support to a child placed in the custody of an agency . . . for a period of six months . . .

Law of June 19, 1969, ch. 911, § 2, 1969 N.C. Sess. Laws 1047 (formerly codified at N.C. GEN. STAT. § 7A-288 (1969)). This section was repealed in 1977 and replaced by N.C. GEN. STAT. §§ 7A-289.22 to .34 (Cum. Supp 1977), effective October 1, 1977. Because the action in *Dinsmore* was instituted prior to October 1, 1977, the case was decided under former § 7A-288.

7. N.C. GEN. STAT. § 48-2. Section 48-2(3a) provides that "an abandoned child shall be any child who has been willfully abandoned at least six consecutive months immediately preceding institution of an action or proceeding to declare the child to be an abandoned child." *Id.* § 48-2(3a).

Section 48-2(3b), which is similar to former § 7A-288(3), *quoted in* note 6 *supra*, provides that an abandoned child is "a child who has been placed in the care of a child-caring institution or foster home, and whose parent . . . has failed substantially and continuously for a period of more than six months to maintain contact with such child, and has willfully failed for such period to contribute adequate support to such child." The court must also find that diligent but unsuccessful efforts have been made on the part of the institution or a child placing agency to encourage the parent to strengthen the parental or custodial relationship to the child. *Id.* § 48-2(3b).

8. The criminal wilfulness test is taken from *State v. Whitener*, 93 N.C. 590, 592 (1885), in which the Supreme Court of North Carolina held that:

The word willful, used in a statute creating a criminal offense, means something more than an intention to do a thing. It implies the doing the act purposely and deliberately, indicating a purpose to do it, without authority—careless whether he has the right or not—in violation of law, and it is this which makes the criminal intent, without which one can not be brought within the meaning of a criminal statute.

In re Hoose, 243 N.C. 589, 91 S.E.2d 555 (1956), read this definition of wilfulness into § 48-2. *In re Maynor*, 38 N.C. App. 724, 248 S.E.2d 875 (1978), is a good example of the application of this criminal wilfulness standard to § 48-2. The court in *Maynor* held that petitioner's son, who had been placed in the custody of the social services department by petitioner's wife, had not been abandoned according to the requirements of § 48-2(3a) or (3b), because petitioner was unaware of his wife's actions and did not intentionally refrain from supporting his son but was prevented from doing so by his incarceration.

9. 36 N.C. App. at 725-27, 245 S.E.2d at 388-89.

10. N.C. GEN. STAT. ch. 7A, art. 24B (Cum. Supp. 1977).

appeals to terminate parental rights despite indications that the best interest of the child would be served by termination. The case further suggests possible unintended interpretations of the current statutes dealing with termination of parental rights. Because this decision was the first to interpret former G.S. 7A-288(1) and (3), the court, rather than relying upon the definitions in the adoption statute,¹¹ could have adopted more flexible definitions of "abandonment" and "willful refusal to provide adequate support" to achieve a desirable result from the standpoint of the child's welfare. The court's refusal to terminate respondent's parental rights leaves the child in an uncertain state, incapable of being permanently placed in a new home through adoption¹² and unable to return to respondent's custody because of respondent's behavior.¹³

The new provision, G.S. 7A-289.32, would, on its face, dictate a different result in *Dinsmore*.¹⁴ The current provisions give the court the ability to decide disputes involving parental rights on the basis of the best interest of the child and vest the court with broad discretionary power in reaching its decision whether to terminate parental rights.¹⁵

11. See notes 7 & 8 *supra*.

12. Consent of the parent is required for adoption unless the parent's rights to the child have been judicially terminated or the court finds that the child has been abandoned as defined in § 48-2. N.C. GEN. STAT. § 48-5 (Cum. Supp. 1977).

13. See note 4 *supra*.

14. N.C. GEN. STAT. § 7A-289.32 (Cum. Supp. 1977) provides six grounds for terminating parental rights:

- (1) The parent has without cause failed to establish or maintain concern or responsibility as to the child's welfare.
- (2) The parent has physically abused or neglected the child
- (3) The parent has willfully left the child in foster care for more than two consecutive years without showing to the satisfaction of court that substantial progress has been made within two years in correcting those conditions which led to the removal of the child for neglect, or without showing positive response within two years to the diligent efforts of a county department of social services . . . to encourage the parent to strengthen the parental relationship to the child or to make and follow through with constructive planning for the future of the child.
- (4) The child has been placed in the custody of a county department of social services . . . and the parent, for a continuous period of six months next preceding the filing of the petition, has failed to pay a reasonable portion of the cost of care for the child.
- (5) One parent has been awarded custody . . . and the other parent whose parental rights are sought to be terminated has for a period of one year or more . . . willfully failed without justification to pay for the care, support, and education of the child, as required by said decree or custody agreement.
- (6) (deals with the father of children born out of wedlock)

If *Dinsmore* had been decided under these provisions, respondent's parental rights could arguably have been terminated on the basis of § 7A-289.32(1), (3) or (4).

15. Section 7A-289.22(3) specifically states that the interest of the child is paramount in deciding disputes involving termination of parental rights. *Id.* § 7A-289.22(3).

No provision of G.S. 7A-289.32,¹⁶ which lists six grounds for terminating parental rights, requires that the child be abandoned before parental rights can be terminated, and the term "willful" is deleted from the new counterpart to former G.S. 7A-288(3), which provided for termination upon willful failure to support.¹⁷ Nevertheless, it is possible that the terms "without cause" in G.S. 7A-289.32(1), which provides for termination when the parent has without cause failed to act responsibly for the child's welfare, and "willfully left" in G.S. 7A-289.32(3),¹⁸ which provides for termination when the parent has willfully left the child under foster care for over two consecutive years, could be interpreted in the same manner as former G.S. 7A-288(1) and (3) were interpreted in *Dinsmore*. This interpretation would frustrate the legislative intent of the current provisions;¹⁹ but, considering the court's approach in *Dinsmore*, such an interpretation is not unlikely.

2. Child Custody

Potential conflict between the statutory mandate to award custody to the person or agency that will best promote the interest and welfare of the child,²⁰ and the strong presumption that the natural parent may not be deprived of custody except upon "convincing proof" of some "extraordinary fact or circumstance,"²¹ was definitively resolved by the court of appeals in *In re Kowalzek*.²² The child in the *Kowalzek* case, whose natural mother was alive, had been in the custody of another couple for three years.²³ Although the natural parent was not deprived of custody because of insufficient findings of fact by the lower court

16. *Id.* § 7A-289.32, quoted in note 14 *supra*.

17. *Id.* § 7A-289.32(4); see notes 6 & 14 *supra*.

18. N.C. GEN. STAT. § 7A-289.32(1), (3) (Cum. Supp. 1977), quoted in note 14 *supra*.

19. Article 24B is to be liberally construed to promote the best interests of the child. *Id.* § 7A-289.22(3).

20. *Id.* § 50-13.2(a).

21. *Thomas v. Pickard*, 18 N.C. App. 1, 4, 195 S.E.2d 339, 342 (1973). This language describing the conditions under which a parent may be deprived of custody is typical. The supreme court similarly stated in *Spitzer v. Lewark*, 259 N.C. 50, 53-54, 129 S.E.2d 620, 623 (1963), that the parent's natural and legal right to custody may not "lightly be denied or interfered with" except for the "most substantial and sufficient reasons."

22. 37 N.C. App. 364, 246 S.E.2d 45, cert. denied, 295 N.C. 734, 248 S.E.2d 863 (1978).

23. Petitioner (the mother) left her husband and infant son, Jeffrey, on December 1, 1974, and returned to her former home in Minnesota. Jeffrey lived with his father until February 28, 1975, when his father was killed in an automobile accident. Petitioner was aware of her husband's death but did not attempt to locate her son. Legal custody of Jeffrey was awarded to the Lee County Department of Social Services, and physical custody of Jeffrey was awarded to Mrs. Liendo and her sister in March 1975. Jeffrey had been living with the Liendos since that time. *Id.* at 365-66, 246 S.E.2d at 45-46.

concerning her fitness as guardian,²⁴ the *Kowalzek* court explicitly held that the natural parent does not have to be found unfit to be deprived of custody.²⁵ The statutory directive, therefore, outweighs the presumption favoring the natural parent. Although fitness of the parent is of greatest importance in determining what course of action will best promote the interests of the child, it is not conclusive.²⁶ This decision was implicit in prior case law²⁷ and is consistent with the court's repeated emphasis on the best interests of the child as the "polar star"²⁸ in custody disputes.

In keeping with the North Carolina court's treatment of visitation rights as a form of custody,²⁹ the supreme court in *Clark v. Clark*³⁰ expressly stated that "[v]isitation privileges are but a lesser degree of custody"³¹ and held that the term "custody" as used in G.S. 50-13.7³² includes visitation rights.³³ Consequently, modification of an award of

24. *Id.* at 369-70, 246 S.E.2d at 48.

25. *Id.* at 368, 246 S.E.2d at 47.

26. The question whether the court *must* award custody to a third person if the natural parent is found unfit remains open. It is possible that the best interest of the child would require that the child remain in the custody of an unfit parent. *Cf.* N.C. GEN. STAT. §§ 7A-289.31(a), (b) (Cum. Supp. 1977) (finding one or more grounds for terminating parental rights does not require termination of parent's rights unless in best interests of the child to do so).

27. North Carolina courts have consistently held that a parent's natural right to custody is not absolute, and that while a parent is ordinarily entitled to custody as against all other persons, custody may be judicially denied for substantial reasons. *E.g.*, *In re Stancil*, 10 N.C. App. 545, 179 S.E.2d 844 (1971). *See also In re Bowen*, 7 N.C. App. 236, 172 S.E.2d 62 (1970). In discussing who between the mother and father should be awarded custody of their child, the court in *Bowen* stated, "We do not understand the law in this jurisdiction to be . . . that a change in custody may not be ordered absent a finding that the person having custody under a prior order has become unfit or is no longer able or suited to retain custody." *Id.* at 241-42, 172 S.E.2d at 65.

While a specific finding that the natural parent was unfit has been made in almost every North Carolina case in which the natural parent was deprived of custody, *e.g.*, *In re Hughes*, 254 N.C. 434, 119 S.E.2d 189 (1961), the court of appeals in *In re Morrison*, 6 N.C. App. 47, 169 S.E.2d 228 (1969), awarded custody to the paternal grandparents without an express finding that the mother was unfit.

28. *E.g.*, *Ridenhour v. Ridenhour*, 225 N.C. 508, 514, 35 S.E.2d 617, 620 (1945).

29. *See, e.g.*, *Montgomery v. Montgomery*, 32 N.C. App. 154, 231 S.E.2d 26 (1977) (award of visitation rights, analogous to award of custody, should contain findings of fact that support conclusion that party is fit person to visit child and that such visitation rights are in best interests of child); *In re Stancil*, 10 N.C. App. 545, 179 S.E.2d 844 (1971) (award of visitation rights, like award of custody, is exercise of judicial function).

30. 294 N.C. 554, 243 S.E.2d 129 (1978).

31. *Id.* at 575-76, 243 S.E.2d at 142.

32. N.C. GEN. STAT. § 50-13.7 (1976) provides:

(a) An order of a court of this State for custody or support, or both, of a minor child may be modified at any time, upon . . . a showing of changed circumstances . . .

(b) When an order for custody or support, or both, of a minor child has been entered by a court of another state, a court of this State may, . . . upon a showing of changed circumstances, enter a new order . . . which modifies or supersedes such order for custody or support.

33. 294 N.C. at 576, 243 S.E.2d at 142.

visitation rights, as in modification of custody awards, requires a showing of changed circumstances.³⁴ The court in *Clark* made it clear that this requirement of a showing of changed circumstances before a visitation award can be modified is absolute. Reversing the court of appeals, the court held that a court must "determine whether changed circumstances affecting the welfare of the child" justify modification of a visitation award even when the parties have agreed that the court may change their visitation privileges without such a showing.³⁵

3. Child Support

The supreme court in *Elmwood v. Elmwood*³⁶ clarified the types of military payments that are subject to garnishment under G.S. 110-136³⁷ to enforce child support obligations.³⁸ Defendant-garnishee in *Elmwood* was a retired regular officer of the Marine Corps³⁹ and received military retirement and disability payments.⁴⁰ The court held that defendant's retirement pay was subject to garnishment under G.S. 110-136 but that his disability pay was not.⁴¹ Controlling federal law requires that this distinction be drawn between the two types of payments defendant received. Pursuant to 42 U.S.C. § 659, only monies received from the United States as "remuneration for employment" are subject to garnishment in accordance with applicable state law.⁴² While the

34. N.C. GEN. STAT. § 50-13.7(a) (1976), *quoted in note 32 supra*.

35. 294 N.C. at 575, 243 S.E.2d at 141.

36. 295 N.C. 168, 244 S.E.2d 668 (1978).

37. N.C. GEN. STAT. § 110-136 (1978 & Interim Supp. 1978). Section 110-136(a) provides:

Notwithstanding any other provision of the law, in any case in which a responsible parent is under a court order or has entered into a written agreement . . . to provide child support, a judge . . . may enter an order of garnishment whereby no more than 25 percent (25%) of the responsible parent's monthly disposable earnings shall be garnished for the support of his minor child.

Id. § 110-136(a) (Interim Supp. 1978).

38. For a similar analysis of the types of military payments that are subject to garnishment for alimony, see *Watson v. Watson*, 424 F. Supp. 866 (E.D.N.C. 1976).

39. There is a significant difference between retired regular officers and retired reserve officers. A retired regular officer of the military services is subject to recall to active duty under certain circumstances and remains subject to the Uniform Code of Military Justice, neither of which is true of retired reserve officers. *Hostinsky v. United States*, 292 F.2d 508, 510 (Ct. Cl. 1961). This distinction is determinative of whether military retirement pay is garnishable. See text accompanying notes 41-43 *infra*.

40. 295 N.C. at 170, 244 S.E.2d at 669-70.

41. *Id.* at 180-81, 244 S.E.2d at 676. The court, however, made no finding on whether defendant was actually disabled in support of designation of part of his retirement pay as disability pay.

42. 42 U.S.C. § 659 (1976) states:

Notwithstanding any other provision of law . . . moneys (the entitlement to which is based upon the remuneration for employment) due from, or payable by, the United

retirement pay of retired reserve officers is considered akin to a pension for past services, retirement pay of retired regular officers is considered current compensation for present services.⁴³ True military disability payments obviously have no relationship to performance of services and, therefore, cannot be garnished. Although federal law determines the type of payments received from the United States that can be garnished, state law determines the extent to which the appropriate payments can be garnished. G.S. 110-136 restricts the extent to which defendant's retirement pay may be garnished for child support to twenty-five percent of his monthly disposable retirement income.⁴⁴

A novel question concerning the ability of one party to pay the attorneys' fees of the other party in a child support action was presented to the court of appeals in *Wyatt v. Wyatt*.⁴⁵ Plaintiff father in *Wyatt* claimed the trial court erred in considering his present wife's income in determining his ability to pay the attorneys' fees of his former wife incurred in an action brought by the former wife for support of a child by the former marriage.⁴⁶ Apparently relying on the broad discretion bestowed upon North Carolina courts by G.S. 50-13.6⁴⁷ to determine an award of reasonable attorneys' fees in a child custody or support action,⁴⁸ the court of appeals held that the income of plaintiff's present wife was a proper factor to consider in assessing his financial circumstances and ability to pay the former wife's counsel fees.⁴⁹ The court reasoned that consideration of plaintiff's present wife's income was justified because plaintiff's present wife was a member of his household, shared in the responsibility for supporting the household, and was the mother of all three children living in the household.⁵⁰ Nevertheless, the *Wyatt* decision should not be read to imply that consideration of a second spouse's income is generally appropriate in

States . . . to any individual including members of the armed services, shall be subject, in like manner and to the same extent as if the United States were a private person, to legal process brought for the enforcement, against such individual of his legal obligations to provide child support or make alimony payments.

43. 23 Comp. Gen. 284, 286 (1943).

44. N.C. GEN. STAT. § 110-136(a) (Interim Supp. 1978), *quoted in note 37 supra*.

45. 35 N.C. App. 650, 242 S.E.2d 180 (1978).

46. *Id.* at 651, 242 S.E.2d at 181.

47. N.C. GEN. STAT. § 50-13.6 (1976) specifically authorizes an award of reasonable attorneys' fees in an action for child support or custody or a modification of an existing order for child support or custody.

48. *See* *Kearns v. Kearns*, 6 N.C. App. 319, 170 S.E.2d 132 (1969). The court in *Wyatt* cites no authority to support its holding.

49. 35 N.C. App. at 651-52, 242 S.E.2d at 181-82.

50. *Id.*

determining financial ability under G.S. 50-13.6. In *Wyatt*, plaintiff himself introduced evidence of his present wife's income;⁵¹ under similar circumstances in *Wyche v. Wyche*,⁵² plaintiff father did not introduce evidence of his second wife's income and the court made no inquiries about her income.⁵³

B. Divorce and Alimony

1. Relation with Separation Agreement

Several recent decisions⁵⁴ have dispelled much of the lingering confusion over the nature and incidents of the relationship between a separation agreement and a divorce decree. A divorce decree may merely approve the separation agreement of the parties or the separation agreement may be incorporated and adopted into the divorce decree.⁵⁵ The power of the court to modify support payments set forth in the separation agreement and the types of remedies available to enforce the provisions of the agreement depend upon whether the separation agreement is adopted or only approved by the court.⁵⁶ The supreme court in *Levitch v. Levitch*⁵⁷ further described how to make the critical distinction between court adoption and court approval of a separation agreement.

The separation agreement in *Levitch* had been incorporated by reference into a divorce decree, but not specifically adopted by the court as its own order. Plaintiff wife sought to enforce the support provisions of the agreement through the court's contempt power.⁵⁸ Be-

51. *Id.* at 652, 242 S.E.2d at 182.

52. 29 N.C. App. 685, 225 S.E.2d 626, *cert. denied*, 290 N.C. 668, 228 S.E.2d 459 (1976).

53. Plaintiff's "new family" was mentioned in *Wyche, id.* at 687, 225 S.E.2d at 628, but no specific reference was made to his present wife. Plaintiff's affidavit of financial standing, which listed his income and expenses, did not include any income from his present wife. Record at 28-31.

54. *Levitch v. Levitch*, 294 N.C. 437, 241 S.E.2d 506 (1978); *Britt v. Britt*, 36 N.C. App. 705, 245 S.E.2d 381 (1978); *White v. White*, 37 N.C. App. 471, 246 S.E.2d 591 (1978). For a discussion of *Britt* and *White*, see text accompanying notes 106-19 *infra*.

55. In the former case, "the court merely approves or sanctions the payments which the husband has agreed to make for the wife's support and sets them out in a judgment against him. Such a judgment constitutes nothing more than a contract between the parties made with the approval of the court." In the latter case, however, "the court adopts the agreement of the parties as its own determination of their respective rights and obligations and orders the husband to pay the specified amounts as alimony." *Bunn v. Bunn*, 262 N.C. 67, 69, 136 S.E.2d 240, 242 (1964).

56. Unlike separation agreements that have been adopted by a court, separation agreements that have merely been *approved* by a court may not be modified by the court upon a showing of changed circumstances and are not enforceable by contempt. *Id.*

57. 294 N.C. 437, 241 S.E.2d 506 (1978).

58. *Id.* at 438, 241 S.E.2d at 507.

cause only those agreements that have been adopted by the court can be enforced through the court's contempt power,⁵⁹ determination of whether these provisions were enforceable by contempt necessarily involved a finding of whether the trial court adopted the agreement as its own adjudication of the rights of the parties or merely approved the agreement. The trial court specifically ordered that the agreement be incorporated by reference into the divorce decree but did not order defendant husband to make the support payments specified therein.⁶⁰ The court in *Levitch* was thus presented with the question whether a specific court order that the supporting spouse make the support payments set out in a separation agreement is necessary for court adoption of the agreement. Reversing the court of appeals, the supreme court held that an order to incorporate a separation agreement into a divorce decree does not require a specific order to comply with the support provisions of the agreement to give the agreement the force of a judicial decree and, thereby, render it enforceable through the contempt power of the court.⁶¹

Prior case law was silent on the precise issue addressed by the *Levitch* court, but suggested that a court order to make the payments agreed upon in a separation agreement was required for court adoption of the agreement.⁶² In *Bunn v. Bunn*,⁶³ the landmark case defining the differences between court approval and court adoption of a separation agreement, the supreme court stated that in consent judgments that endow the separation agreement with the force of a judicial decree "the court adopts the agreement of the parties as its own determination of their respective rights and obligations *and* orders the husband to pay the specified amounts as alimony."⁶⁴ Subsequent cases reinforced the idea that a court order to make support payments was a prerequisite to court adoption of the agreement. In explaining the two types of consent judgments described in *Bunn*, the supreme court in *Mitchell v. Mitchell*⁶⁵ stated, "When . . . a court . . . *orders* the husband to make specified payments to his wife for her support, his wilful failure to comply with the court's judgment will subject him to attachment for con-

59. See note 56 *supra*.

60. 294 N.C. at 439, 241 S.E.2d at 507.

61. *Id.* at 440, 241 S.E.2d at 508.

62. *E.g.*, *Mitchell v. Mitchell*, 270 N.C. 253, 154 S.E.2d 71 (1967); *Bunn v. Bunn*, 262 N.C. 67, 136 S.E.2d 240 (1964).

63. 262 N.C. 67, 136 S.E.2d 240 (1964).

64. *Id.* at 69, 136 S.E.2d at 242 (emphasis added).

65. 270 N.C. 253, 154 S.E.2d 71 (1967).

tempt. . . . This is true . . . 'because the judgment requires the payment.'"⁶⁶ The *Levitch* decision makes it clear, however, that a divorce decree can require compliance with support payments set forth in a separation agreement through court adoption of the agreement without specifically ordering that the support payments be made.

Because the *Levitch* court looked to the trial court's intent in ordering incorporation of the agreement to determine whether the agreement had the effect of a judicial decree,⁶⁷ this decision should be read with a measure of caution and should not be interpreted to mean that an order of incorporation without a specific order to comply with the support provisions of the agreement automatically converts the separation agreement into a judicial decree. A court may not always intend that the separation agreement be adopted by the court when the provisions of the agreement are incorporated into a divorce decree but are not expressly made the subject of the court's own order.⁶⁸ In addition, the divorce judgment may be a consent judgment,⁶⁹ in which case the intent of the parties, not that of the court, controls in determining the effect of the judgment.⁷⁰ Thus, had the *Levitch* judgment been a consent judgment,⁷¹ language contained in the agreement stating that the agreement was not to be merged in a divorce decree,⁷² could properly have been given more weight in interpreting the effect of the decree than was given it in *Levitch*.

2. Divorce from Bed and Board

In *Triplett v. Triplett*,⁷³ a case of first impression, the court of appeals considered whether one spouse may pursue an action for divorce from bed and board⁷⁴ and alimony while both spouses are staying together in the same house. Defendant husband in *Triplett* had moved

66. *Id.* at 256, 154 S.E.2d at 73 (quoting *Sessions v. Sessions*, 178 Minn. 79, 80, 226 N.W. 701, 701 (1929) (per curiam)) (emphasis added).

67. 294 N.C. at 439, 241 S.E.2d at 507-08.

68. See *Williford v. Williford*, 10 N.C. App. 451, 179 S.E.2d 113, cert. denied, 278 N.C. 301, 180 S.E.2d 177 (1971). The court in *Williford* held that incorporation of the support provisions of a separation agreement into a divorce decree without a specific order to either party to comply with the incorporated provisions was not sufficient to establish court adoption of the agreement.

69. Divorce decrees based on separation for the statutory period are typically consent judgments. See, e.g., *Bunn v. Bunn*, 262 N.C. 67, 136 S.E.2d 240 (1964).

70. *Yount v. Lowe*, 288 N.C. 90, 215 S.E.2d 563 (1975); 46 AM. JUR. *Judgments* § 73 (1969).

71. 294 N.C. at 439, 241 S.E.2d at 507-08.

72. The separation agreement in *Levitch* contained a proviso that it should survive a divorce decree but not be merged therein. *Id.* at 439, 241 S.E.2d at 507.

73. 38 N.C. App. 364, 248 S.E.2d 69 (1978).

74. N.C. GEN. STAT. § 50-7 (1976) provides:

out of the marital abode prior to plaintiff's initiation of the divorce and alimony action, but he occasionally stayed with plaintiff for several days at a time and was staying with plaintiff during the hearing in the action.⁷⁵ Plaintiff sought a divorce from bed and board and alimony on the basis of defendant's wilful failure to provide her with support⁷⁶ and his excessive use of alcohol.⁷⁷ With little discussion of the issue presented, the court held that spouses do not have to be living apart to prosecute an action for divorce from bed and board.⁷⁸

The *Triplett* holding is stated too briefly because living apart is obviously a condition for divorce from bed and board on the statutory grounds of abandonment or maliciously turning the other spouse out of doors. Nevertheless, the decision promotes a desirable policy of refusing to find condonation, through continued cohabitation by the parties, of continuing marital offenses such as cruelty and habitual drunkenness.⁷⁹ This decision should be read with caution, however. Facts of the case reveal that plaintiff and defendant had indeed separated; they were not living together when the action was initiated, and defendant was only staying at plaintiff's residence temporarily during the hearing.

3. Changed Circumstances

The court of appeals in *Stallings v. Stallings*⁸⁰ considered whether post-divorce sexual misconduct of a dependent ex-spouse can constitute changed circumstances, thereby justifying modification of a per-

The court may grant divorces from bed and board on application of the party injured . . . in the following cases:

- (1) If either party abandons his or her family.
- (2) Maliciously turns the other out of doors.
- (3) By cruel or barbarous treatment endangers the life of the other.
- (4) Offers such indignities to the person of the other as to render his or her condition intolerable and life burdensome.
- (5) Becomes an excessive user of alcohol or drugs so as to render the condition of the other spouse intolerable and the life of that spouse burdensome.

75. 38 N.C. App. at 365-66, 248 S.E.2d at 71.

76. This claim is presumably an allegation of constructive abandonment. Several decisions involving plaintiffs seeking alimony without divorce on the basis of abandonment have held plaintiff's allegations that defendant wilfully refused to provide plaintiff with adequate support sufficient to state a claim for alimony without divorce on the ground of constructive abandonment. *See, e.g.,* *Brady v. Brady*, 273 N.C. 299, 160 S.E.2d 13 (1968). No decision, however, has granted a divorce from bed and board on the ground of constructive abandonment.

77. Abandonment and habitual drunkenness are grounds for divorce from bed and board under N.C. GEN. STAT. § 50-7(1), (5) (1976) as well as for alimony without divorce under *id.* § 50-16.2(4), (9).

78. 38 N.C. App. at 366, 248 S.E.2d at 71.

79. *See generally* 1 R. LEE, NORTH CAROLINA FAMILY LAW § 83 (1963 & Supp. 1976).

80. 36 N.C. App. 643, 244 S.E.2d 494, *cert. denied*, 295 N.C. 648, 248 S.E.2d 249 (1978).

manent alimony award.⁸¹ Defendant payor in *Stallings* claimed that his former wife's occasional post-divorce fornication was a changed circumstance requiring termination or reduction in his alimony payments to her.⁸² Taking a strict statutory approach, the court concluded that post-divorce sexual misconduct does not provide a basis for modification or termination of an alimony award because the term "changed circumstance" as used in G.S. 50-16.9(a)⁸³ refers only to financial needs and abilities of the former spouses. The court further noted that post-divorce sexual misconduct is not included as a ground for termination of alimony under G.S. 50-16.9(b),⁸⁴ which provides that alimony shall terminate upon the payee's remarriage.⁸⁵

C. Separation Agreements

In *Murphy v. Murphy*,⁸⁶ the North Carolina Supreme Court, for the first time, squarely addressed the question "whether a husband and wife who, after having executed a separation agreement and established separate abodes, continue to engage in sexual intercourse from time to time thereby rescind the [separation] agreement."⁸⁷ Reversing the court of appeals,⁸⁸ the supreme court in *Murphy* held that sexual

81. An alimony award may be modified upon a showing of changed circumstances pursuant to N.C. GEN. STAT. § 50-16.9(a) (1976).

82. 36 N.C. App. at 643-44, 244 S.E.2d at 495.

83. N.C. GEN. STAT. § 50-16.9(a) (1976).

84. *Id.* § 50-16.9(b).

85. 36 N.C. App. at 644-45, 244 S.E.2d at 495.

86. 295 N.C. 390, 245 S.E.2d 693 (1978).

87. *Id.* at 394, 245 S.E.2d at 696.

The North Carolina Supreme Court had previously held that a resumption of the conjugal relationship between husband and wife, after a separation agreement has been duly executed, rescinds the agreement. *State v. Gossett*, 203 N.C. 641, 166 S.E. 754 (1932); *Smith v. King*, 107 N.C. 273, 12 S.E. 57 (1890) (per curiam). Similarly, the supreme court has consistently held that a separation agreement between husband and wife is terminated, insofar as it remains executory, upon their reconciliation and resumption of marital cohabitation. *E.g., In re Estate of Adamee*, 291 N.C. 386, 230 S.E.2d 541 (1976). The supreme court, however, has never defined the terms "resumption of the conjugal relationship," "reconciliation" or "resumption of marital cohabitation," and their meaning is not clear from the context of the cases. *Gossett* equated "conjugal relationship" with sexual intercourse; the case held that a deed of separation is invalid if after its execution the husband continues to visit his wife from time to time and upon each visit they engage in sexual intercourse. 203 N.C. at 642-44, 166 S.E. at 754-55. In *Smith*, the phrase "resumption of the conjugal relationship" described the wife's actions in moving back into the marital abode and residing there with her husband as man and wife for 12 months. 107 N.C. at 6, 12 S.E. at 57. "Resumption of marital cohabitation" in *Adamee* also described the situation in which the husband and wife move back into the marital abode and live as they did before the separation and execution of a separation agreement. 291 N.C. at 393, 230 S.E.2d at 546. No supreme court case, prior to *Murphy*, had discussed what is the minimally sufficient conduct by a husband and wife that constitutes a reconciliation, and, therefore, an abrogation of the separation agreement.

88. 34 N.C. App. 677, 239 S.E.2d 597 (1977), *rev'd*, 295 N.C. 390, 245 S.E.2d 693 (1978).

intercourse between husband and wife after the execution of a separation agreement rescinds the agreement regardless of whether their sexual encounters are "casual," "isolated," or otherwise"⁸⁹ and irrespective of any intent, or lack thereof, by the parties to renew their marital relationship.⁹⁰ The court in *Murphy* held the separation agreement executed by plaintiff and defendant invalid solely because of the parties' intermittent⁹¹ post-separation sexual intercourse.

This decision is supported neither by reason nor by precedent. It directly conflicts with a desirable policy of preserving marriages by encouraging reconciliation attempts between separated spouses who have made a separation agreement, it is a much narrower holding than the facts of the case demanded,⁹² and it inexplicably rejects case law developed by the court of appeals.⁹³

The decision in *Murphy* is based almost exclusively⁹⁴ on *State v.*

89. 295 N.C. at 397, 245 S.E.2d at 698.

90. *Id.* at 395, 245 S.E.2d at 697.

91. Plaintiff's and defendant's testimony on the exact number of times they engaged in sexual intercourse after executing a separation agreement conflicted, but both admitted to having done so at least six times. Defendant wife estimated the number at more than two dozen. *Id.* at 393-94, 245 S.E.2d at 695-96.

92. The facts in *Murphy* indicated frequent visits between plaintiff and defendant, occasionally coupled with sexual activity. There was conflicting evidence about whether the parties intended to reconcile their differences and begin living together again as husband and wife. 295 N.C. at 392-93, 245 S.E.2d at 695-96.

93. *Murphy* impliedly overruled *Cooke v. Cooke*, 34 N.C. App. 124, 237 S.E.2d 323, cert. denied, 293 N.C. 740, 241 S.E.2d 513 (1977), and *Newton v. Williams*, 25 N.C. App. 527, 214 S.E.2d 285 (1975), both of which held that a reconciliation between husband and wife sufficient to rescind a separation agreement requires a mutual intent to resume cohabitation in a normal relationship of husband and wife and that sexual intercourse alone does not abrogate the agreement. These cases are in accord with the overwhelming majority of jurisdictions that have considered the question. 1 A. LINDEY, SEPARATION AGREEMENTS AND ANTE-NUPTIAL CONTRACTS § 8 (1964 & Supp. 1978). "The usual judicial approach is to be circumspect in finding that reconciliation [necessitating rescission of the agreement] has occurred." Wadlington, *Sexual Relations After Separation or Divorce: The New Morality and the Old and New Divorce Laws*, 63 VA. L. REV. 249, 261-62 (1977).

94. The court also cited the Lindey treatise and several cases from other jurisdictions in support of its conclusion. 295 N.C. at 397, 245 S.E.2d at 698 (citing 1 A. LINDEY, *supra* note 93, § 8, at 13; *Weeks v. Weeks*, 143 Fla. 686, 197 So. 393 (1940); *Wolff v. Wolff*, 134 N.J. Eq. 8, 34 A.2d 150 (1943); *Ahrens v. Ahrens*, 67 Okla. 147, 169 P. 486 (1917)). These cites, however, do not support the *Murphy* decision; the statement taken from Lindey is quoted out of context and the cases are either not on point or have been limited by later decisions in their respective jurisdictions.

The court in *Murphy* cited Lindey in support of its statement that severance of marital relations by a separation agreement and continued sexual intercourse are "essentially antagonistic and irreconcilable notions." 295 N.C. at 397, 245 S.E.2d at 698 (quoting 1 A. LINDEY, *supra* note 93, § 8 at 13). Lindey, however, unequivocally states that "[a]brogation [of a separation agreement] . . . is a matter of intention; it does not arise automatically as a matter of law." 1 A. LINDEY, *supra* note 93, § 8, at 14.

Weeks v. Weeks, 143 Fla. 686, 197 So. 393 (1940), was a case cited by the court that was later limited. *Weeks* held that plaintiff's and defendant's resumption of the marital relationship in

Gossett,⁹⁵ This reliance is misplaced, however, because *Gossett* is easily distinguished from *Murphy* on its facts. *Gossett*, a prosecution for criminal abandonment and nonsupport, was decided at a time when separation agreements were not favored by North Carolina courts⁹⁶ and presented a compelling factual situation for rescission of the separation agreement. As a defense to prosecution, defendant pleaded a separation agreement in which his wife relinquished any interest she might have in his property. Evidence in the case clearly indicated that defendant's wife had no independent counsel when she signed the agreement, that she did not understand the provisions of the separation agreement and that she was rendered destitute by the terms of the agreement.⁹⁷ The court in *Gossett* upheld defendant's conviction, finding the separation agreement had been invalidated due to defendant's post-separation sexual intercourse with his wife every time he visited her.⁹⁸

In *Murphy*, on the other hand, the separation agreement was drawn up entirely by defendant wife's attorney, defendant was fully aware of the extent of plaintiff's assets, and defendant was adequately provided for by the terms of the agreement.⁹⁹ Furthermore, there was

travelling together as man and wife on several occasions after separation abrogated their separation agreement. Subsequently, in *Busot v. Busot*, 338 So. 2d 1332, 1334 (Fla. Dist. Ct. App. 1976) (dictum), the Florida Court of Appeals stated that the facts in *Weeks* showed a true reconciliation between spouses while the facts in *Busot* (sexual intercourse between the parties an undisclosed number of times coupled with unsuccessful attempts at reconciliation) did not. The court in *Busot* explained the distinction, stating, "[o]bviously, reconciliation requires an intention of the parties to reconcile and this requires more than some occasional post-separation sexual experiences." *Id.* at 1334-35.

Wolff v. Wolff, 134 N.J. Eq. 8, 34 A.2d 150 (1943), held a separation agreement raised by the husband as a defense to his wife's separate maintenance suit invalid for a number of reasons: the agreement was grossly unfair to plaintiff wife who had no independent counsel when the separation agreement was executed, and the agreement was void as against public policy because it facilitated divorce. In enumerating the laws of the separation agreement, the court stated without discussion that the parties' continued normal cohabitation following execution of the separation agreement, as though the agreement had never been made, effectively put an end to it. *Id.* at 141, 34 A.2d at 156 (dictum). Nothing in the opinion indicates what the court meant by "normal" cohabitation.

In *Ahrens v. Ahrens*, 67 Okla. 147, 169 P. 486 (1917), plaintiff and defendant resumed living together for a period of 10 days after execution of a separation agreement. *Id.* at 148, 169 P. at 487. Therefore, the issue in the case was not whether there was sufficient contact between husband and wife *short of actually living together* to rescind a separation agreement.

95. 203 N.C. 641, 166 S.E. 754 (1932).

96. The court's hostility to separation agreements was openly acknowledged. *Id.* at 643, 166 S.E. at 754.

97. *Id.* at 642, 166 S.E. at 754.

98. *Id.* at 643-44, 166 S.E. at 755.

99. Record at 50-51, 72-79, 85-86, 94, *Murphy v. Murphy*, 34 N.C. App. 677, 239 S.E.2d 597 (1977). By the terms of the agreement defendant wife was to receive a lump-sum alimony award of \$12,000, all the household and kitchen furniture, a 1968 Oldsmobile, and a house trailer and lot

no pervading fear in *Murphy*, as in *Gossett*, of separation agreements being used by husbands as a means to escape the financial responsibilities of marriage while remaining free to enjoy the benefits of marriage by continuing to engage in sexual intercourse with their estranged wives.¹⁰⁰

The holding in *Murphy* becomes even more surprising when considered in light of prior North Carolina Supreme Court decisions that imply that post-separation sexual activity between spouses who have no intention of resuming a marital relationship does not interrupt the statutory separation period and, thereby, bar a divorce based on separation under G.S. 50-5(4)¹⁰¹ or 50-6.¹⁰² In both *Young v. Young*¹⁰³ and *In re Estate of Adamee*¹⁰⁴ the supreme court held that separation under G.S. § 50-5(4) or G.S. § 50-6 "means cessation of cohabitation, and cohabitation means living together as man and wife, though not necessarily implying sexual relations. Cohabitation includes other marital responsibilities and duties [aside from sex]."¹⁰⁵

The *Murphy* decision is unsound for the reasons discussed above and, accordingly, should be strictly limited to its facts. In light of the circumstances of the case, the words "isolated" and "casual," held in *Murphy* to describe sexual relations sufficient to rescind a separation agreement, can perhaps be construed to mean "from time to time" or "intermittent."

The court of appeals, in two recent cases, clarified the relationship between provisions in a separation agreement pertaining to support

at Topsail Beach, North Carolina. Evidence indicated that plaintiff owned a substantial interest in Murphy Mills, Incorporated and Murphy Farm Company; each company's assets were valued at greater than \$100,000. The provisions of the separation agreement, however, must be considered in light of the strong evidence indicating that defendant committed adultery. Adultery is a complete bar to alimony in North Carolina. N.C. GEN. STAT. § 50-16.6(a) (1976).

100. 203 N.C. at 644, 166 S.E. at 755.

101. N.C. GEN. STAT. § 50-5(4) (1976) provides that a marriage may be dissolved by divorce on application of the injured party if the husband and wife have lived separate and apart for one year.

102. *Id.* § 50-6 (Interim Supp. 1978) provides that a marriage may be dissolved by divorce on application of either party if the husband and wife have lived separate and apart for one year.

103. 225 N.C. 340, 34 S.E.2d 154 (1945).

104. 291 N.C. 386, 230 S.E.2d 541 (1976).

105. 225 N.C. at 344, 34 S.E.2d at 157 (citations omitted); 291 N.C. at 391-92, 230 S.E.2d at 546. Consistent with this definition of separation is *Tuttle v. Tuttle*, 36 N.C. App. 635, 244 S.E.2d 446 (1978), in which the court of appeals held that the statutory separation period was not interrupted by mere social contact between the parties without any cohabitation in the sense of living together as man and wife or intent to resume the marital relationship. Defendant in *Tuttle* stayed in plaintiff's home one night over the Christmas holidays for the purpose of visiting her children and did not have sexual relations with plaintiff.

and those pertaining to a property settlement. In *Britt v. Britt*,¹⁰⁶ the court of appeals erased any doubt about the separability of support and property settlement provisions in a separation agreement that has been adopted by the court. In *White v. White*,¹⁰⁷ the court indicated factors relevant to the determination of whether these provisions are separable.

Although it had previously been held by implication¹⁰⁸ and stated in dictum¹⁰⁹ that provisions in a separation agreement for the division of property rights and for support payments may be included as separable provisions that remain separable upon adoption of the agreement by the court, *Britt* was the first decision to hold expressly that such property settlement and support provisions are separable. The separation agreement in *Britt* expressly stated that the support provisions were independent from any agreement for division of property and should not for any purpose be considered "to be a part of or merged in

106. 36 N.C. App. 705, 245 S.E.2d 381 (1978).

107. 37 N.C. App. 471, 246 S.E.2d 591 (1978).

108. In *Seaborn v. Seaborn*, 32 N.C. App. 556, 233 S.E.2d 67 (1977), the issue before the court was whether a consent judgment could be modified to permit greater support payments upon a showing of changed circumstances. By provision one of the consent judgment, plaintiff husband agreed to pay \$150 per month to defendant wife until she died or remarried. By provisions two and three of the consent judgment, plaintiff deeded his interest in one piece of real property owned jointly by them to defendant, and defendant deeded her interest in another piece of real property owned jointly by them to plaintiff. *Id.* at 556-57, 233 S.E.2d at 68. The agreement, therefore, contained both provisions for support and property division. In holding that the support provision was modifiable the court necessarily held that the support provision and the property settlement in the consent judgment were separable. The court cited *Bunn v. Bunn*, 262 N.C. 67, 136 S.E.2d 240 (1964), in support of its conclusion that the support provision and property settlement provision of the consent judgment were separable. *Id.* at 558, 233 S.E.2d at 69.

109. Both *Holsomback v. Holsomback*, 273 N.C. 728, 732, 161 S.E.2d 99, 102-03 (1968), and *Bunn v. Bunn*, 262 N.C. 67, 70, 136 S.E.2d 240, 243 (1964), contain dictum stating that provisions for support and property division may be included in a consent judgment as separable provisions. The *Bunn* court stated:

[A]n agreement for the division of property rights and an order for the payment of alimony may be included as separable provisions in a consent judgment. In such event the division of property would be beyond the power of the court to change, but the order for future installments of alimony would be subject to modification in a proper case. However, if the support provision and the division of property constitute a reciprocal consideration so that the entire agreement would be destroyed by a modification of the support provision, they are not separable and may not be changed without the consent of both parties.

Id. at 70, 136 S.E.2d 243 (citations omitted).

Similarly, the court in *Holsomback* stated:

In the consent judgment which Judge May purported to set aside, the parties agreed upon a division of their property and upon the amount of alimony which defendant should pay plaintiff until her death or remarriage. This judgment was . . . a decree of the court. The order with reference to the payment of future installments of alimony was, therefore, subject to modification by the court in the event of changed conditions. The agreed division of property, a separable provision, however, was beyond the power of the judge to modify without the consent of both parties.

273 N.C. at 732, 161 S.E.2d at 102-03 (citations omitted).

or integrated with a property settlement of the parties.”¹¹⁰ The court did not discuss the relevance of any other aspects of the agreement to its finding that the provisions were separable, but considered this language in the separation agreement determinative of whether the provisions were separable.¹¹¹

In contrast, the court of appeals in *White* enumerated several factors considered by courts in other jurisdictions¹¹² to be relevant to a determination of the severability of support and property settlement provisions in a separation agreement. Factors relevant to a finding that the provisions are severable include the wife's claim for alimony in the divorce action,¹¹³ a provision in the agreement that the support payments would terminate in the event of the wife's remarriage,¹¹⁴ lack of evidence that the amount of the support payments was based on the value of any property given as consideration for the payments,¹¹⁵ and language in the agreement itself indicating that the agreement was not a final settlement of rights and duties of the parties with respect to both property and support.¹¹⁶ Finding that the support payments in *White* had every indicia of alimony and no evidence that the support payments and the provisions for a property settlement were interrelated,¹¹⁷ the *White* court concluded that the payments denominated as “permanent alimony” in the divorce action consent judgment were precisely that, and, therefore, severable.¹¹⁸

None of the factors enumerated by the court in *White* is determinative, however. The court expressly stated that each case involving the issue of separability of support and property settlement provisions must be decided upon its own facts.¹¹⁹

Other 1978 cases involving disputes over separation agreements

110. 36 N.C. App. at 711, 245 S.E.2d at 385.

111. *Id.*

112. The court examined cases from New Mexico, Montana and California. 37 N.C. App. at 476-77, 246 S.E.2d at 594-95.

113. *Movius v. Movius*, 163 Mont. 463, 517 P.2d 884 (1976).

114. *Id.*

115. *Scanlon v. Scanlon*, 60 N.M. 43, 287 P.2d 238 (1955). *But see* *Washington v. Washington*, 512 P.2d 1300 (Mont. 1973) (provisions for support and property division held nonseparable because one party assumed preexisting liabilities against part of the property as partial consideration for support payments).

116. California courts in particular emphasize the wording of the agreement. *See, e.g., DiMarco v. DiMarco*, 60 Cal. 2d 387, 385 P.2d 2, 33 Cal. Rptr. 610 (1963).

117. By the terms of the agreement, defendant was to pay plaintiff \$100 per week until she remarried or died and \$1,000 in a lump sum as well as convey his half interest in their home to plaintiff. 37 N.C. App. at 472-73, 246 S.E.2d at 593.

118. *Id.* at 477-78, 246 S.E.2d at 595.

119. *Id.* at 477, 246 S.E.2d at 595.

were resolved by the court of appeals by applying principles of contract law.¹²⁰ Stressing contract rules of interpretation, the term "single" used in separation agreements¹²¹ was determined as a matter of law to mean "unmarried" in *Hall v. Hall*.¹²² Defendant's argument that "single" was ambiguous and was intended to mean "alone"¹²³ was rejected in favor of a common sense interpretation of the word.

In *Stanback v. Stanback*,¹²⁴ the court of appeals held that the measure of damages for breach of a separation agreement was the same as for any other contract. Plaintiff and defendant in *Stanback* agreed that defendant husband would pay plaintiff's attorneys' fees. In a subsequent amendment to this agreement, plaintiff agreed to pay her own attorneys' fees in exchange for increased support payments and defendant's promise to pay any federal or state income tax plaintiff incurred by not being able to deduct the attorneys' fees in determining her tax liability. Plaintiff was unable to deduct \$28,500 of the attorneys' fees, and defendant did not pay this deficiency as he had promised.¹²⁵ Plaintiff's claims for both consequential and punitive damages for defendant's breach were dismissed for insufficiency.¹²⁶ The claim for consequential damages for mental anguish was dismissed because the tax arrangement was commercial as opposed to personal in nature.¹²⁷ The claim for punitive damages was not allowed because the tax provi-

120. Separation agreements between husband and wife are generally construed in accordance with rules and provisions applicable to contracts in general. *Bowles v. Bowles*, 237 N.C. 462, 75 S.E.2d 413 (1953).

121. The term "single" as used in separation agreements had never been interpreted by the court of appeals before. A similar issue was raised in *Riddle v. Riddle*, 32 N.C. App. 83, 230 S.E.2d 809 (1977), however. The separation agreement in *Riddle* provided that the husband was to pay his wife \$600 per month until she either died or remarried. Plaintiff began living with another man, and defendant ceased making the agreed upon payments. The court held that plaintiff's cohabitation with another man to whom she was not married did not furnish a defense to plaintiff's duty to support defendant pursuant to the agreement.

122. 35 N.C. App. 664, 242 S.E.2d 170, *cert. denied*, 295 N.C. 260, 245 S.E.2d 777 (1978).

123. By the terms of the agreement, defendant was obligated to pay plaintiff \$300 per month as long as she remained single. Defendant argued that plaintiff was no longer "single" because she was living with another man. *Id.* at 664, 242 S.E.2d at 171-72.

124. 37 N.C. App. 324, 246 S.E.2d 74, *cert. granted*, 295 N.C. 649, 248 S.E.2d 253 (1978) (No. 44 PC).

125. *Id.* at 325, 246 S.E.2d at 76.

126. *Id.* at 327-31, 246 S.E.2d at 77-80.

127. A personal contract is one in which "the contractual duty or obligation is so coupled with matters of mental concern or solicitude, or with the sensibilities of the party to whom the duty is owed, that a breach of that duty will necessarily or reasonably result in mental anguish or suffering" such as a contract of marriage or a contract to enter a body in specified manner. *Lamm v. Shingleton*, 231 N.C. 10, 14, 55 S.E.2d 810, 813 (1949). Compensatory damages for mental anguish may be recoverable for breach of personal, but not commercial, contracts. *Id.*

sion was commercial and because plaintiff failed to allege any separate identifiable tortious conduct sufficient to justify such an award.

Consistent with the North Carolina courts' refusal to enforce extra-judicial separation agreements through the contempt power of the court,¹²⁸ the court of appeals, in *Sainz v. Sainz*¹²⁹ and *Moore v. Moore*,¹³⁰ held that a separation agreement that has not been adopted in a court order may not be enforced by specific performance. This prohibition against enforcement of extra-judicial separation agreements by a decree of specific performance is absolute; it applies when arrearages in support payments provided for in the separation agreement have been reduced to judgment¹³¹ as well as when plaintiff has obtained a foreign decree of specific performance to enforce such an agreement.¹³² Reasoning that plaintiffs in *Sainz* and *Moore* sought specific performance decrees to compel defendants to comply with extra-judicial separation agreements under threat of being jailed for contempt,¹³³ the court refused to order specific performance of the agreements.¹³⁴

Even though plaintiff in *Sainz* had a New York judgment ordering specific performance of the agreement, this judgment was not given effect by the North Carolina court because of the policy and law of North Carolina that contractual rights may not be enforced by civil contempt proceedings.¹³⁵ This holding does not violate the full faith and credit clause of the United States Constitution. That clause re-

128. See, e.g., *Stanley v. Stanley*, 226 N.C. 129, 37 S.E.2d 118 (1946).

129. 36 N.C. App. 744, 245 S.E.2d 372 (1978).

130. 38 N.C. App. 700, 248 S.E.2d 761 (1978), *rev'd* 297 N.C. 14, — S.E.2d — (1979).

131. Plaintiff in *Moore* sought specific performance of an extra-judicial separation agreement after a judgment obtained against defendant for arrearages in payments set forth in the agreement proved worthless. *Id.* at 700, 248 S.E.2d at 761. The dissent in *Moore* would grant plaintiff the remedy of specific performance of the agreement under those circumstances in which plaintiff's remedy at law—judgment for the accrued payments—has proven inadequate. *Id.* at 702-03, 248 S.E.2d at 762-63 (Webb, J., dissenting).

132. Plaintiff in *Sainz* asked the North Carolina court to give effect to a New York judgment ordering defendant to specifically perform the separation agreement. 36 N.C. App. at 745, 245 S.E.2d at 373.

133. 36 N.C. App. at 746-47, 245 S.E.2d at 374; 38 N.C. App. at 701, 248 S.E.2d at 761.

134. A similar situation confronted the court of appeals in *Riddle v. Riddle*, 32 N.C. App. 83, 230 S.E.2d 809 (1977). Injunctive relief sought by plaintiff to compel her ex-husband to make the support payments agreed upon in their extra-judicial separation agreement was denied because the effect of an injunction would be to compel defendant to make the support payments under threat of enforcement by contempt proceedings.

135. N.C. CONST. art. I, § 28 prohibits imprisonment for debts. Separation agreements that have not been incorporated into a court decree and ordered by the court are nothing more than civil contracts and cannot be enforced by contempt proceedings, the gist of which is wilful disobedience to a court order. See *Stanley v. Stanley*, 226 N.C. 129, 37 S.E.2d 118 (1946).

quires that foreign judgments be recognized by courts of sister states, but does not require recognition of the specified method of enforcement.¹³⁶

The North Carolina Supreme Court, however, reversed the decision of the court of appeals in *Moore* and held that, for the first time in North Carolina, a separation agreement that has not been incorporated in a divorce decree may be enforced by an order of specific performance.¹³⁷ Although the court distinguished earlier North Carolina decisions holding that contempt orders may not be invoked to enforce a separation agreement not made a part of a divorce decree,¹³⁸ it did not address the question whether a civil contempt proceeding would be available to force compliance with a decree of specific performance used to enforce an extra-judicial separation agreement. Without the threat of a court's contempt power, however, an order of specific performance would be of little benefit to a financially dependent former spouse.

SABRA J. FAIRES

IX. PROPERTY¹

A. *Mortgages, Deeds of Trust and Statutory Liens*

The North Carolina Court of Appeals in *In re Deed of Trust of*

136. The methods by which a judgment of another state is enforced are determined by the local law of the forum. *Sistare v. Sistare*, 218 U.S. 1, 26 (1909). See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 99 (1971).

137. 297 N.C. 14, 252 S.E.2d 735 (1979).

138. *Id.* at 16, 252 S.E.2d at 737 (distinguishing *Stanley v. Stanley*, 226 N.C. 129, 37 S.E.2d 118 (1946); *Brown v. Brown*, 224 N.C. 556, 31 S.E.2d 529 (1944)).

1. The court of appeals decided cases of interest in the areas of vendor-purchaser and cemeteries in 1978. In an action for specific performance of a contract to convey a house with abatement of the purchase price, the court in *Nugent v. Beckham*, 37 N.C. App. 557, 246 S.E.2d 541 (1978), held that there was not an absolute right to interest on the purchase price for vendors in such an action. The court refused to award interest because defendant vendors would have received an amount in excess of that awarded to plaintiff purchasers for rents and profits and thus would have realized a net gain from their refusal to convey the land. In another vendor-purchaser case, *Passmore v. Woodard*, 37 N.C. App. 535, 246 S.E.2d 795 (1978), the court determined that plaintiff was entitled to receive sums paid pursuant to an option agreement to purchase land from defendants when defendants were unable to deliver clear title to the property. The court further held that plaintiff could recover the \$5000 he spent for improvements on the land but only to the extent that plaintiff could show that the improvements enhanced the value of the land.

In *Singletary v. McCormick*, 36 N.C. App. 597, 244 S.E.2d 731 (1978), the court of appeals

*Watts*² limited the jurisdiction of a superior court judge in a hearing de novo under G.S. 45-21.16(d)³ to determine a creditor's right to foreclosure under a power of sale. The superior court in *Watts*, citing equitable reasons, had reversed the finding of the clerk that a creditor was entitled to foreclosure.⁴ The court of appeals held that in the hearing on the right to foreclosure required by G.S. 45-21.16(d) the clerk of superior court is limited to the four findings specified in the statute and that in a hearing de novo on appeal the superior court is similarly limited and may not invoke its equitable jurisdiction.⁵

The court of appeals found first that G.S. 45-21.16 was the legislative response to the due process requirements laid down in *Turner v. Blackburn*.⁶ It then concluded that those requirements were met by

interpreted for the first time the statute authorizing removal and relocation of graves, N.C. GEN. STAT. § 65-13(a)(2) (1975). Under the statute a church may remove graves "in order to erect a new church . . . [or] in order to expand or enlarge an existing church facility" The court read "in order to" to signify "as the means to" and held that a church could remove graves for the purpose of relocating a street on the grave-site so that the area of the existing street could be used for the construction of a new church building.

2. 38 N.C. App. 90, 247 S.E.2d 427 (1978).

3. N.C. GEN. STAT. § 45-21.16(d) (Supp. 1977), discussed in note 5 *infra*.

4. 38 N.C. App. at 91-92, 247 S.E.2d at 427-28. North Carolina recognizes two types of foreclosure: foreclosure by action or judicial sale in which the court may order a sale; and the power of sale foreclosure in which the authority to foreclose arises from a power of sale granted in the mortgage or deed of trust. The power of sale foreclosure is preferred by most creditors because it is quicker, simpler and less expensive. See generally J. WEBSTER, REAL ESTATE LAW IN NORTH CAROLINA §§ 248-254 (1971 & Supp. 1977).

5. 38 N.C. App. at 94, 247 S.E.2d at 429. In addition to complying with the provisions of the mortgage or deed of trust, a creditor foreclosing under a power of sale must comply with the minimum statutory requirements, designed to protect the debtor, specified in N.C. GEN. STAT. §§ 45-4 to -21.45 (1976 & Supp. 1977). See J. WEBSTER, *supra* note 4, § 252, at 307. N.C. GEN. STAT. § 45-21.16 (Supp. 1977) requires that, in a power of sale foreclosure, notice of hearing be sent to the debtor and any record owner of the real estate on which the lien is held and that a hearing be conducted to determine the creditor's right to foreclosure. Subsection (d) of that statute provides in part:

The hearing . . . shall be held before the clerk of court in the county where the land . . . is situated. Upon such hearing, the clerk shall consider the evidence of the parties. . . . If the clerk finds the existence of (i) valid debt . . . , (ii) default, (iii) right to foreclose under the instrument, and (iv) notice to those entitled to such under subsection (b), then the clerk shall authorize the mortgagee or trustee to proceed under the instrument, and the mortgagee or trustee can give notice of and conduct a sale pursuant to the provisions of this Article. The act of the clerk in so finding or refusing to so find is a judicial act and may be appealed to the judge of the district or superior court having jurisdiction at any time within 10 days after said act. Appeals from said act of the clerk shall be heard de novo.

N.C. GEN. STAT. § 45-21.16(d) (Supp. 1977). Whether or not the debtor appears at this hearing the creditor must present affirmative evidence sufficient for the clerk to make the findings required. See Note, *Real Property—Changes in North Carolina's Foreclosure Law*, 54 N.C.L. REV. 903, 917 (1976).

6. 389 F. Supp. 1250 (W.D.N.C. 1975). *Turner* held the former North Carolina procedure for foreclosure under power of sale, Law of Apr. 1, 1948, ch. 720, 1949 N.C. Sess. Laws 788, unconstitutional as applied. 389 F. Supp. at 1261. Finding state action in the extensive participa-

less than a full hearing and found instead that the "notice and hearing required by G.S. 45-21.16 were designed to enable the mortgagor to utilize the injunctive relief already available in G.S. 45-21.34."⁷ While recognizing that a superior court judge has general equitable jurisdiction,⁸ the court stated that it may be invoked only in a "proper proceeding," which was, in this context, an action to enjoin a foreclosure sale under G.S. 45-21.34.⁹

Although the court correctly found that the legislative purpose was to meet the standards enunciated in *Turner*, it misinterpreted the constitutional requirements that must be met in achieving that purpose. The court's analysis is faulty because of a failure to perceive that the *Turner* decision was only a part of the application of due process requirements to debtor-creditor procedures that began with the United States Supreme Court decisions in *Sniadach v. Family Finance Corp.*¹⁰ and *Fuentes v. Shevin*,¹¹ and because of a misreading of *Turner* itself. The implication of *Watts* is that due process may be satisfied in power of sale foreclosures by providing the debtor with notice and a partial

tion of the clerk in the procedure, the *Turner* court found that the procedure did not comport with due process because it made no provision for personal notice to the debtor or for a prior hearing. 389 F. Supp. at 1254-58. The court further found that the power of sale contained in a deed of trust did not effectively waive the debtor's rights. *Id.* at 1260-61. It therefore ruled that future foreclosures would be unlawful unless there was either a "knowing, voluntary, and intelligent waiver" or both "adequate and timely notice" and "opportunity for a hearing." *Id.* at 1261. See generally Note, *supra* note 5. The *Turner* decision led to the passage of substantial amendments to the foreclosure statutes a few months later. *Id.* at 916; Law of June 6, 1975, ch. 492, 1975 N.C. Sess. Laws 509 (codified as amended at N.C. GEN. STAT. §§ 45-21.9, .16, .16A, .17, .21, .29, .30, .33, .45 (1976 & Supp. 1977)). For a discussion of the changes that these amendments made in the North Carolina procedure, see J. WEBSTER, *supra* note 4, § 252 (Supp. 1977).

7. 38 N.C. App. at 94, 247 S.E.2d at 429. N.C. GEN. STAT. § 45-21.34 (1976) provides in part:

Any owner of real estate . . . may apply to a judge of the superior court, prior to the confirmation of any sale of such real estate by a mortgagee . . . , to enjoin such sale or the confirmation thereof, upon the ground that the amount bid or price offered therefor is inadequate and inequitable and will result in irreparable damage to the owner . . . , or upon any other legal or equitable ground which the court may deem sufficient.

For a discussion of the interpretation and application of this statute, see note 13 and accompanying text *infra*.

8. This jurisdiction is derived from the general grant of judicial power to the General Court of Justice found in N.C. CONST. art. IV, § 1.

9. 38 N.C. App. at 94, 247 S.E.2d at 429.

10. 395 U.S. 337 (1969).

11. 407 U.S. 67 (1972). In *Fuentes* the Supreme Court held unconstitutional the Pennsylvania and Florida replevin statutes that permitted a secured creditor to seize the goods of a defaulting debtor pending a full hearing on the merits. *Id.* at 96. *Fuentes* and *Sniadach* established the proposition that before a debtor may be deprived of his property by a creditor he must be given notice and a prior opportunity to be heard. See *id.*; 395 U.S. at 343 (Harlan, J., concurring). While the "nature and form of such prior hearings" might be "open to many potential variations," *Fuentes* required that the hearing "provide a real test." 407 U.S. at 96-97.

hearing because he may then avail himself of injunctive relief to block the foreclosure.¹² *Fuentes*, however, permitted a partial hearing at an early stage only on the condition that a full hearing on the merits be provided later.¹³ The injunctive relief available under G.S. 45-21.34, on the other hand, does not afford the debtor such a hearing because, as interpreted by the courts, it only permits an action after the foreclosure sale and it provides relief only on a showing that the sale price was inadequate coupled with some other inequity.¹⁴ Thus, as a result of *Watts*, although a debtor may have a valid equitable defense sufficient to bar foreclosure, he cannot utilize it until the foreclosure sale has become a *fait accompli* and then only if the price bid can be proven inadequate. This can only be regarded as the unconstitutional denial of a forum to the debtor.

The *Turner* court recognized these shortcomings in requiring that the mortgagor "be given an opportunity for a hearing *before* he is deprived of any significant property interest"¹⁵ and in specifying that at this hearing "the mortgagor must of course be afforded the opportunity to rebut and defend the charges."¹⁶ Clearly, the restricted hearing

12. See note 7 and accompanying text *supra*. It has even been argued that notice alone may meet the requirements of due process in a foreclosure under power of sale. See Comment, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 220-22 (1972).

13. See 407 U.S. at 82.

14. The conclusion that an injunction may be granted only after the sale has occurred may be inferred from the nature of the proof required to entitle a party to relief. In *Woltz v. Asheville Safe Deposit Co.*, 206 N.C. 239, 173 S.E. 587 (1934), the court held that Law of Apr. 18, 1933, ch. 275, § 1, 1933 N.C. Pub. Laws 401 (codified as amended at N.C. GEN. STAT. § 45-21.34 (1976)) gave a superior court judge the power to enjoin a *previous* sale or confirmation thereof only when the price bid was shown to be inadequate. The court noted that "[t]he statute is remedial only." 206 N.C. at 242, 173 S.E.2d at 589. Later decisions added the requirement that the party seeking an injunction show some other "irregularity," as well as inadequacy of price. *Certain-Teed Prods. Corp. v. Sanders*, 264 N.C. 234, 246, 141 S.E.2d 329, 337 (1965); *Foust v. Gate City Sav. & Loan Ass'n*, 233 N.C. 35, 37, 62 S.E.2d 521, 523 (1950). Obviously, a party seeking an injunction cannot show that the price bid at the sale was inadequate until that sale has been conducted. Further, in *Sanders* the court held that when the statute required that the action be commenced "prior to confirmation" it referred to the confirmation required by the clerk in the event of an upset bid and not to the consummation of a sale generally. 264 N.C. at 244, 141 S.E.2d at 336. Because N.C. GEN. STAT. § 45-21.27 (1976) requires that an upset bid be filed within 10 days after the sale and because no confirmation would be required after that time, the implication to be drawn from *Sanders* is that a party seeking injunction of the foreclosure must wait until the sale is held, and then has only 10 days to commence his action if no upset bid is made.

15. 389 F. Supp. at 1259 (quoting *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971)). The *Turner* court further stated:

The extraordinary injunctive relief available under § 45-21.34 does not suffice [as a hearing] because (1) the burden of proof is clearly on the mortgagor; (2) he most likely must show irreparable damage, as by inadequacy of the bid; and (3) a condition precedent to relief is a bond providing for full indemnification.

Id. at 1259.

16. *Id.*

required by the court of appeals is not the one contemplated by *Turner*. Therefore, while the *Watts* court's restriction of defenses in a hearing pursuant to G.S. 45-21.16 might be considered a victory for quick, efficient foreclosure,¹⁷ it will probably not withstand constitutional scrutiny.

In *In re Deed of Trust of Simon*,¹⁸ the court of appeals was again called upon to construe the scope and application of G.S. 45-21.16, this time in relation to the statute's appellate bond requirement.¹⁹ The debtor in *Simon* appealed an adverse judgment of the clerk in a foreclosure proceeding, first to the superior court and then to the court of appeals. Upon each appeal the debtor was required to post a bond "to protect the petitioner from *any probable loss by reason of delay in the foreclosure.*"²⁰ At the conclusion of all appeals in favor of the creditor a hearing was held in the superior court on the creditor's motion for determination of damages and costs resulting from the delay in foreclosure.²¹ The trial court determined that the creditor was entitled to damages far in excess of the total amount of the bonds, as measured primarily by interest on the indebtedness, and the debtor appealed.²²

Employing an analogy to cases involving injunction bonds, the court of appeals held that when a party elects to proceed on the appellate bond his damages are limited to the amount of the bond.²³ *Turn-*

17. The court of appeals further grounded its construction of the statute on the conclusion that to permit a full hearing under § 45-21.16(d) would make the power of sale foreclosure as costly and time-consuming as the foreclosure by action it was designed to avoid. 38 N.C. App. at 94, 247 S.E.2d at 429. As the late Professor Webster emphatically observed, however, with the decision in *Turner* and the General Assembly's consequent amendment of the foreclosure statutes, "every foreclosure, even under power of sale, is in effect a 'judicial foreclosure.'" J. WEBSTER, *supra* note 4, § 252, at 63 (Supp. 1977) (footnote omitted). The *Turner* court considered even the former North Carolina procedure to involve so much "detailed statutory authority" that it became nothing more than "a streamlined version of a judicial sale." 389 F. Supp. at 1258. Manifestly, the conclusion to be drawn from cases such as *Fuentes* and *Turner* is that when the state becomes involved in streamlined procedures for creditors to reclaim secured property the streamlining cannot come at the expense of debtors' due process rights.

18. 36 N.C. App. 51, 243 S.E.2d 163 (1978).

19. N.C. GEN. STAT. § 45-21.16(d) (Supp. 1977), provides in part:

If an appeal is taken from the clerk's findings, the appealing party shall post a bond with sufficient surety as the clerk deems adequate to protect the opposing party from any probable loss by reason of appeal; and upon posting of the bond the clerk shall stay the foreclosure pending appeal.

20. 36 N.C. App. at 52-53, 243 S.E.2d at 164 (quoting order of superior court).

21. *Id.* at 53-55, 243 S.E.2d at 164-65.

22. *Id.* at 55, 243 S.E.2d at 165-66.

23. *Id.* at 56, 243 S.E.2d at 166 (citing Local 755, IBEW v. Country Club East, Inc., 283 N.C. 1, 194 S.E.2d 848 (1973); *Shute v. Shute*, 180 N.C. 386, 104 S.E. 764 (1920)). The court noted that in such cases

a person wrongfully restrained could elect either (1) to recover only the amount of the

ing to the question of interest as a measure of damages, the court first determined that the bond specified in G.S. 45-21.16(d) applied only to an appeal from the clerk to the district or superior court and that in any further appeal the general appeal bond provision for real property actions, G.S. 1-292, would continue to apply.²⁴ The court then concluded that because of the broad language used in describing the bond required by G.S. 45-21.16(d) interest on the indebtedness would be an appropriate measure of damages.²⁵

The *Simon* decision is commendable for several reasons. First, the extension to appellate bonds of the rule limiting recovery of damages to the amount of the bond clarifies the law in this area and is long overdue.²⁶ Second, confining application of the bond provided for in G.S. 45-21.16(d) to appeals from the clerk is also a much needed clarification. Finally, the court's expansive interpretation of the interests protected by that bond should permit a more accurate reflection of a creditor's actual damages than previously provided by other bonds in this area.²⁷

The court of appeals erred, however, in its conclusion that interest on the indebtedness would be an appropriate measure of damages in all cases in which the bond required by G.S. 45-21.16(d) is sued upon. Previously, in cases involving suits upon the bond required for the enjoining of a foreclosure under G.S. 45-21.34, interest had been permitted as a measure of damages only on a showing that the value of the

bond for the damages he has suffered simply by petitioning the trial court in that action for recovery or (2) to forego his action on the bond and bring an independent tort-suit for malicious prosecution.

Id. at 56, 243 S.E.2d at 166. North Carolina permits a tort action for malicious civil action only on a showing of "special damages beyond those normally incident to a civil proceeding." Byrd, *Malicious Prosecution in North Carolina*, 47 N.C.L. REV. 285, 308 (1969). Presumably a similar tort action would be permitted for abuse of appellate process with similar requirements of proof.

24. 36 N.C. App. at 56-57, 243 S.E.2d at 166-67. N.C. GEN. STAT. § 1-292 (1969) provides that in appeals from the trial courts involving real property a bond is required to cover "waste" and "the value of the use and occupation of the property."

The *Simon* court reasoned that because the legislature in enacting § 45-21.16 was only concerned with making the North Carolina foreclosure procedure comport with due process, *see* note 6 and accompanying text *supra*, it could not have been interested in "the more traditional and constitutionally permissible procedures for appeal from the district court or the superior court to the Court of Appeals." 36 N.C. App. at 57, 243 S.E.2d at 166-67.

25. 36 N.C. App. at 57-58, 243 S.E.2d at 167.

26. Although it is in keeping with the general law on the subject, *see* 5B C.J.S. *Appeal & Error* § 2064 (1958), this is apparently the first North Carolina decision applying the rule to appellate bonds.

27. Compare N.C. GEN. STAT. § 45-21.16(d) (Supp. 1977) ("any probable loss by reason of delay in the foreclosure"), with *id.* § 1-292 (1969) ("waste" and "the value of the use and occupation of the property"), and *id.* § 45-21.34 (1976) ("costs, depreciation, interest, and other damages").

land, prior to the date of an injunction, was insufficient to pay the indebtedness and accrued interest.²⁸ The obvious reason for this distinction was that, unless the value of the land was insufficient to meet the debt prior to the injunction, the creditor would presumably be compensated for the delay, either by the sale price at foreclosure, or by damages measured by depreciation during the period of injunction.²⁹ Because of the similarity of damages arising from a delay in foreclosure caused by an injunction and those arising from a delay caused by an appeal, the effect of the decision in *Simon* will be to give the creditor, in some cases, double compensation, first in damages awarded on the bond and again in the price bid at the foreclosure sale.

In *Ross Realty Co. v. First Citizen's Bank & Trust Co.*³⁰ the North Carolina Supreme Court tightened the restrictions under G.S. 45-21.38 on a vendor's recovery on a purchase money mortgage or deed of trust.³¹ A vendee in default of a purchase money deed of trust offered to return the deed to the vendor.³² The vendor refused the deed and proceeded to sue on the promissory note.³³ The court of appeals, applying a literal construction of the statute, held that although G.S. 45-21.38 prohibits a deficiency judgment after foreclosure, it does not bar a suit on the note prior to foreclosure.³⁴

28. See, e.g., *First Nat'l Bank v. Hicks*, 207 N.C. 157, 176 S.E. 249 (1934) (permitting interest on the value of the land); *Gruber v. Ewbanks*, 199 N.C. 335, 154 S.E. 318 (1930) (permitting interest on the indebtedness).

29. See *Gruber v. Ewbanks*, 199 N.C. 335, 339, 154 S.E. 318, 321 (1930).

30. 296 N.C. 366, 250 S.E.2d 271 (1979), *rev'g*, 37 N.C. App. 33, 245 S.E.2d 404 (1978).

31. N.C. GEN. STAT. § 45-21.38 (1976) provides in pertinent part:

In all sales of real property by mortgagees and/or trustees under powers of sale contained in any mortgage or deed of trust . . . to secure to the seller the payment of the balance of the purchase price of real property, the mortgagee or trustee or holder of the notes secured by such mortgage or deed of trust shall not be entitled to a deficiency judgment on account of such mortgage, deed of trust or obligation secured by the same: Provided, said evidence of indebtedness shows upon the face that it is for balance of purchase money for real estate

In further action relating to § 45-21.38, the court of appeals held in *Armell Management Corp. v. Stanhagen*, 35 N.C. App. 571, 241 S.E.2d 713 (1978), that the statute was not applicable when the vendee purchased a leasehold interest from the vendor and executed a note for the purchase price secured by a deed of trust conveying other property previously purchased from the vendor. The court found that a deed of trust is a purchase money deed of trust only if it embraces the property purchased in the same transaction. *Id.* at 573, 241 S.E.2d at 714-15; see *Dobias v. White*, 239 N.C. 409, 412, 80 S.E.2d 23, 26 (1954).

32. 37 N.C. App. at 33, 245 S.E.2d at 405.

33. *Id.*

34. *Id.* at 35, 245 S.E.2d at 406. Finding no North Carolina decisions on point, the court based its decision on the construction given a similar statute by an Oregon court. *Id.* (citing *Page v. Ford*, 65 Or. 450, 131 P. 1013 (1913) (construing Law of Feb. 24, 1903, 1903 Or. Laws 252 (current version at OR. REV. STAT. § 88.070 (1977))).

The issue whether § 45-21.38 applies to a suit on the promissory note prior to foreclosure was

The supreme court reversed and held that the statute has the effect of limiting the vendor solely to his remedy in foreclosure.³⁵ The court rejected a literal construction of the statute and looked instead to the intent of the legislature for guidance in its interpretation of the statute.³⁶ The court found that the "manifest intention of the legislature was to limit the creditor to the property conveyed when the note and mortgage or deed of trust are executed to the seller of real estate."³⁷ As a further reason for adopting a broad construction of the statute, the court pointed to the "anomalous situation" the court of appeals acknowledged to be the result of its interpretation of the statute, and concluded that the legislature could not have intended such circumvention.³⁸

The supreme court's decision is open to attack on a number of grounds. First, while the court purported to follow the legislative intent, its perception of that intention was drawn almost solely from a law review article written nearly thirty years after enactment of the statute.³⁹ The analysis in that article, in turn, was primarily conjecture based on the historical context in which the statute was enacted.⁴⁰ Sec-

previously presented to the court of appeals in *Gambill v. Barr*, 32 N.C. App. 597, 232 S.E.2d 870 (1977), but was avoided when the court held that the statute did not apply because the deed of trust did not show on its face that it was for the purchase price. Further, it has been held that the statute does not apply when the purchase money deed of trust is a junior lien and the first deed of trust is foreclosed. *Brown v. Kirkpatrick*, 217 N.C. 486, 8 S.E.2d 601 (1940). An Oregon court in construing an analogous statute, however, held that when the vendor, as the holder of a junior lien, participated in the foreclosure proceeding on the first mortgage and received a share of the overplus in discharge of its indebtedness, the statute did apply. *Ward v. Beem Corp.*, 249 Or. 204, 437 P.2d 483 (1968) (construing OR. REV. STAT. § 88.070 (1977)).

35. 296 N.C. at 370, 250 S.E.2d at 273.

36. *Id.*; accord, *State v. Hart*, 287 N.C. 76, 213 S.E.2d 291 (1975); *Underwood v. Howland*, 274 N.C. 473, 164 S.E.2d 2 (1968).

The court of appeals, on the other hand, had found its construction of the statute limited by the "literal terms of the statute." 37 N.C. App. at 34, 245 S.E.2d at 406; accord, *State v. Camp*, 286 N.C. 148, 209 S.E.2d 754 (1974).

37. 296 N.C. at 370, 250 S.E.2d at 273; see note 39 and accompanying text *infra*.

38. *Id.* at 373, 250 S.E.2d at 275. The court of appeals recognized that, as a result of its decision, a vendor might evade the statute by suing on the note and then having this judgment executed upon the subject property or by simply proceeding to foreclose after suit on the note. 37 N.C. App. at 35, 245 S.E.2d at 406. The Oregon courts seek to avoid such circumvention of their statute, at least in part, by imputing a waiver of the vendor's right to foreclosure when he has previously sued on the note. See *Ward v. Beem Corp.*, 249 Or. 204, 437 P.2d 483 (1968); *Wright v. Wimberly*, 79 Or. 626, 156 P. 257 (1916). Although the adoption of this waiver by the North Carolina courts has been suggested, Note, 35 N.C.L. Rev. 492, 495-96 (1957), the court of appeals in *Ross Realty Co.* chose not to do so. 37 N.C. App. at 35-36, 245 S.E.2d at 406.

39. See 296 N.C. at 370-71, 250 S.E.2d at 273-74 (quoting Currie & Lieberman, *Purchase-Money Mortgage and State Lines: A Study in Conflict-of-Laws Method*, 1960 DUKE L.J. 1, 11-12, 23-24).

40. See Currie & Lieberman, *supra* note 39, at 11-16. The authors acknowledged that there was no conventional legislative history concerning the statute. *Id.* at 11. They viewed Law of

ond, while the supreme court criticized the "anomalous situation" created by the decision below, it failed to recognize a far greater anomaly arising from its own decision. Under a contract of purchase and sale the parties are mutually bound to a bilateral contract,⁴¹ but, as a result of the court's decision, when the contract is merged into the deed and deed of trust, the transaction is converted into a unilateral contract with the vendee having the option to withdraw at any time. Finally, while G.S. 45-21.38 may have been justified by the oppressed condition of the vendee resulting from the speculative nature of the Depression land market, there seems little reason for its existence, much less for an expansion of its scope, today.⁴² While the supreme court's decision in *Ross Realty Co.* has only served to make a bad rule worse, perhaps it will prompt repeal of this dated statute.

In *Frank H. Connor Co. v. Spanish Inns Charlotte, Ltd.*,⁴³ the supreme court updated the statutory definition of the "labor" necessary to establish a mechanics' lien under G.S. 44A-8,⁴⁴ and interpreted the accrual statute, G.S. 44A-10,⁴⁵ that applies to such liens. A contractor perfected his claim of lien on a construction site and brought an action to enforce it.⁴⁶ The trial court held that because the contractor's clear-

Feb. 6, 1933, ch. 36, 1933 N.C. Pub. Laws 28 (codified as amended at N.C. GEN. STAT. § 45-21.38 (1976)), which was passed at the height of the Depression in 1933, as being motivated primarily by a desire to protect the overburdened mortgagor of that time from the inequities produced by a forced sale at depressed prices. Currie & Lieberman, *supra* note 39, at 13-14. They further argued, however, that the statute was intended to be a "permanent change in the law" inasmuch as it is, unlike much of the other legislation passed at the time, prospective and preventive, rather than retroactive and therapeutic. *Id.* at 15-16. Currie and Lieberman believed the legislature did not expressly extend the coverage of the statute to suits on the personal obligation or to land contracts because legislatures "are not always astute to close all loopholes." *Id.* at 23-24. Yet it seems that after 45 years, some session of the General Assembly would have been astute enough to close the loopholes if they were, in fact, regarded as such. A comparison of those states having statutes preventing a deficiency judgment on a purchase money mortgage or deed of trust reveals that the California statute was amended in 1935 to also cover contracts of sale, Law of July 16, 1935, ch. 680, 1935 Cal. Stats. 1868 (current version at CAL. CIV. PROC. CODE § 580b (West 1976)); the Montana, North Carolina, and Oregon statutes make no mention of land contracts, *see* MONT. REV. CODES ANN. § 93-6008 (1964); N.C. GEN. STAT. § 45-21.38 (1976); OR. REV. STAT. § 88.070 (1977); and the South Dakota statutes expressly provide that they do not cover land contracts, *see* S.D. COMPILED LAWS ANN. §§ 44-8-20, -23 (1967).

41. *See* J. CRIBBET, PRINCIPLES OF THE LAW OF PROPERTY 144 (2d ed. 1975).

42. While it may be argued that the vendor gets an unfair advantage through retaining the down payment, foreclosing on the property, and seeking a deficiency judgment, it must be remembered that the vendee also benefits by the lower interest rates that are usually obtainable on a purchase money mortgage or deed of trust. Moreover, the purchase money mortgage or deed of trust often provides an alternative means of financing at a time when conventional loans are unavailable.

43. 294 N.C. 661, 242 S.E.2d 785 (1978).

44. N.C. GEN. STAT. § 44A-8 (1976).

45. *Id.* § 44A-10.

46. 294 N.C. at 664, 242 S.E.2d at 787. N.C. GEN. STAT. § 44A-8 (1976) provides that "[a]ny

ing, surveying and staking of building lines on the site antedated the recording of a construction loan deed of trust on the same property, the mechanics' lien should be given priority.⁴⁷ The lender appealed, contending that the work done by the contractor prior to the recordation of its deed of trust did not constitute the "labor" required to establish a lien under former G.S. 44A-8 and that the lien did not accrue until the "commencement of building."⁴⁸

The supreme court, in rejecting a definition of "labor" as "manual, unskilled work of an inferior and toilsome nature,"⁴⁹ noted that the word had not been construed in over sixty years and concluded that "labor" should, therefore, be broadened to include modern skilled workers.⁵⁰ Such a definition, it held, brought clearing and staking of building lines within the meaning of "labor" as used in G.S. 44A-8.⁵¹ The court further found that G.S. 44A-10 was unique among the fifty

person who performs or furnishes labor or professional design or surveying services or furnishes materials pursuant to a contract . . . with the owner of real property" may establish a lien on that property for the payment of his debts. His lien may be perfected by filing a claim of lien with the clerk of court in the county in which the land is situated within "120 days after the last furnishing of labor or materials at the site," *id.* §§ 44A-11, -12 (1976 & Supp. 1977), and may be enforced by instituting suit within "180 days after the last furnishing of labor or materials at the site," *id.* §§ 44A-11, -13 (1976 & Supp. 1977). The lien then relates back to and takes effect "from the time of the first furnishing of labor or materials at the site," *id.* § 44A-10 (1976), and takes priority over all liens taking effect after that date, *id.* § 44A-14 (1976). See generally Humphrey, *Position, Priorities and Protection of Parties and Statutory Liens*, in NORTH CAROLINA BAR ASSOCIATION FOUNDATION INSTITUTE ON TROUBLED REAL ESTATE VENTURES AND NEW USE AND OWNERSHIP CONCEPTS, at IV-1 (1975); Urban & Miles, *Mechanics' Liens for the Development of Real Property: Recent Developments in Perfection, Enforcement, and Priority*, 12 WAKE FOREST L. REV. 283 (1976).

47. 294 N.C. at 665, 242 S.E.2d at 788.

48. *Id.* at 668, 671, 242 S.E.2d at 789, 791.

49. *Id.* at 668, 242 S.E.2d at 790. The definition proposed by the lender is apparently a distillation of the court's comments about the word in *Stephens v. Hicks*, 156 N.C. 239, 72 S.E. 313 (1911).

50. 294 N.C. at 670, 242 S.E.2d at 90-91.

In further action in 1978 relating to the construction of § 44A-8, the court of appeals in *Raleigh Paint & Wallpaper Co. v. Peacock & Assocs., Inc.*, 38 N.C. App. 144, 247 S.E.2d 728 (1978), *cert. denied*, 296 N.C. 415 (1979), held that a materialman was not required to show that he actually delivered the materials to the site to establish a lien within the meaning of § 44A-8. While recognizing that the contrary interpretation had been suggested by the authors of two recent articles on the subject, see Humphrey, *supra* note 46, at IV-11; Urban & Miles, *supra* note 46, at 287, and that such an interpretation was consistent with the statutory language, the court found that it would not advance the intent of the statutory scheme, which is to provide notice of potential liens to third parties, to impose such a requirement. 38 N.C. App. at 147-48, 247 S.E.2d at 731.

51. 294 N.C. at 671, 242 S.E.2d at 791. This decision was made under § 44A-8 as it read prior to the 1975 amendment, which added the words "professional design or surveying service." See Law of June 23, 1975, ch. 715, § 2, 1975 N.C. Sess. Laws 940 (codified at N.C. GEN. STAT. § 44A-8 (1976)). The court, however, rejected the lender's argument that this amendment indicated that the activities under consideration were not included within the meaning of "labor" under the former law. The court found instead that the amendment was intended as a clarification of, rather than an addition to, the former statute. 294 N.C. at 669, 242 S.E.2d at 790.

states in dating the accrual of a mechanics' lien not from the "commencement of building," but rather from the "first furnishing of labor or materials at the site."⁵² Nevertheless, it held that the statute implicitly requires a "visible commencement of the improvement" and that "partial clearing of the site and the staking of the outlines of the building" were sufficient to meet this requirement.⁵³

The court's broadening of the definition of "labor" is a significant and belated reform in light of the numerous changes that have occurred in the construction industry since the word was last defined.⁵⁴ Although it is not even implicitly required by the statutory language, the court's addition of the "visible commencement" requirement under G.S. 44A-10 is in keeping with the "intent of the draftsmen that persons interested in the subject lot . . . should be able to examine the property and ascertain the extent to which it [is] possibly encumbered."⁵⁵ The decision preserves this opportunity to discover the existence of potential liens on property, while increasing the protection available to a contractor through the use of a mechanics' lien.

52. 294 N.C. at 671, 242 S.E.2d at 791 (quoting N.C. GEN. STAT. § 44A-10 (1976)); see cases cited in Annot., 1 A.L.R.3d 822 (1965).

53. 294 N.C. at 671-72, 242 S.E.2d at 791-92; see *Urban & Miles*, *supra* note 46, at 321.

54. The subject was apparently last discussed in *Stephens v. Hicks*, 156 N.C. 239, 72 S.E. 313 (1911).

55. *Urban & Miles*, *supra* note 46, at 321. In 1978 the court of appeals in *Miller v. Lemon Tree Inn, Inc.*, 39 N.C. App. 133, 249 S.E.2d 836 (1978), held that acceptance of a note maturing beyond the period for perfecting a mechanics' lien and secured by a deed of trust on the same property subject to the lien constitutes a waiver of that lien. *Id.* at 140, 249 S.E.2d at 840-41. Although an earlier North Carolina decision had implied that acceptance of a note maturing beyond the period for perfecting the lien constituted a waiver of that lien, see *Raeford Lumber Co. v. Rockfish Trading Co.*, 163 N.C. 314, 318, 79 S.E. 627, 629 (1913), the court noted a split among the jurisdictions on the effect of taking a note secured by a deed of trust on the identical property subject to the lien, 39 N.C. App. at 138, 249 S.E.2d at 839-40 (citing 57 C.J.S. *Mechanics' Liens* § 227(b) (1948)). It chose to adopt the prevailing view that the intent of the parties is the determinative factor, and held that the taking of a deed of trust upon the same property necessarily shows the parties' intent to waive the lien. *Id.* at 138-39, 249 S.E.2d at 840; accord, *Barrows v. Baughman*, 9 Mich. 213 (1861); *Gorman v. Sagner*, 22 Mo. 137 (1855); *Charles K. Spaulding Logging Co. v. Ryckman*, 139 Or. 230, 6 P.2d 25 (1932). The court did not decide the question whether there is a waiver when the contractor takes security in addition to that provided by the mechanics' lien. 39 N.C. App. at 140, 249 S.E.2d at 840. This decision permits

[o]ne who finds a deed of trust in the obligor's chain of title covering the identical property as would be subject to a materialmen's lien . . . to rely on that as settlement of the obligation when it is recorded prior to perfection of the lien and the maturity date of the note extends beyond the period of perfection.

Id. at 141, 249 S.E.2d at 840.

*B. Covenants*⁵⁶

In *Beech Mountain Property Owners' Association v. Current*,⁵⁷ the North Carolina Court of Appeals confronted the issue whether a property owners' association may enforce a covenant to pay assessments to that body when no covenant provides for enforcement by the association. Plaintiff property owners' association (POA) instituted actions against defendant owners within the subdivision to collect dues and assessments owed it for the maintenance of subdivision facilities and roads.⁵⁸ The POA contended, in reliance on *Neponsit Property Owners' Association v. Emigrant Industrial Savings Bank*,⁵⁹ that covenants in all deeds conveying lots within the subdivision that provided for the formation of a property owners' association, the payment of assessments to that body, and enforcement by the property owners "jointly or severally" implicitly gave the POA the right to enforce the covenants as an agent of the owners.⁶⁰

The court of appeals distinguished *Neponsit* on the ground that in that case the covenant "expressly conferred a right of action on the grantor's 'assigns,' which expressly included the property owners' association."⁶¹ The court further held that because the POA owned no property within the subdivision it could not claim the benefit of the covenant giving "the owners of lots" a right of enforcement.⁶² The

56. In 1978 the North Carolina Court of Appeals held in *Board of Transp. v. Turner*, 37 N.C. App. 14, 245 S.E.2d 223 (1978), that a reservation by the grantor of the right to negotiate with the Board of Transportation concerning a right of way, and of the right to the proceeds resulting from any such condemnation for a period of 10 years, did not constitute a restraint on alienation. Finding this reservation distinguishable from one involving the proceeds of a voluntary sale, the court ruled that it did not restrict the full and free transfer of the property. *Id.* at 17, 245 S.E.2d at 225; accord, *In re Mazzone*, 281 N.Y. 139, 22 N.E.2d 315 (1939). See generally J. WEBSTER, *supra* note 4, § 346, at 445-46; Note, *Real Property—Direct Restraints on Alienation*, 48 N.C.L. REV. 173 (1969).

57. 35 N.C. App. 135, 240 S.E.2d 503 (1978).

58. *Id.* at 135-36, 240 S.E.2d at 505.

59. 278 N.Y. 248, 15 N.E.2d 793 (1938).

60. 35 N.C. App. at 138, 240 S.E.2d at 506.

61. *Id.* at 139, 240 S.E.2d at 507. The fallacy of this distinction is discussed in note 64 and accompanying text *infra*.

62. *Id.*, 240 S.E.2d at 507. The North Carolina courts have long held that when a developer sells lots and imposes common restrictions on use "pursuant to a general plan of development or improvement, such restrictions may be enforced by any grantee against any other grantee, either on the theory that there is a mutuality of covenant and consideration, or on the ground that mutual negative equitable easements are created." *Sedberry v. Parsons*, 232 N.C. 707, 710-11, 62 S.E.2d 88, 90 (1950) (quoting 26 C.J.S. *Deeds* § 167 (1956)). See *Tull v. Doctors Bldg., Inc.*, 255 N.C. 23, 120 S.E.2d 817 (1961); *Higdon v. Jaffa*, 231 N.C. 242, 56 S.E.2d 661 (1949); *Myers Park Homes Co. v. Falls*, 184 N.C. 426, 115 S.E. 184 (1922); *Shipton v. Barfield*, 23 N.C. App. 58, 208 S.E.2d 210, *cert. denied*, 286 N.C. 212, 209 S.E.2d 316 (1974). Even in the absence of a uniform plan of development, a covenant may be enforced by other property owners as third-party benefi-

court concluded with the assumption that "if the grantor had intended to authorize the plaintiff to enforce the provisions as an agent of the property owners, it would have expressed such intent."⁶³

The apparent holding of the court in *Current*, that a property owners' association may enforce a covenant to pay assessments only if the developer expressly so provides, threatens the effectiveness of many land development schemes in North Carolina,⁶⁴ and disregards the development of the law concerning the enforcement of covenants. *Neponsit*, the seminal case in this area, concluded that a property owners' association has the right to enforce a covenant to pay assessments, not as an assignee of the grantor, but as an agent of the property owners. This conclusion was based on the implicit character of a property owners' association as an organization created to advance the common interests of the property owners and not on an express provision by the grantor.⁶⁵ As the court in *Neponsit* noted,

ciaries if "the grantor *intended* to create a negative easement benefiting all the property" and if this intent is reflected in an express provision conferring on other property owners the right to enforce the restrictions. *Lamica v. Gerdes*, 270 N.C. 85, 88, 153 S.E.2d 814, 816 (1967). The courts have, however, required that for a covenant to be enforceable it must benefit a "dominant tenement;" when the party seeking to enforce the covenant owns no land that might be benefited by the covenant, the courts have refused to impose the restriction. *Steagall v. Housing Auth.*, 278 N.C. 95, 178 S.E.2d 824 (1971). See also *Sleepy Creek Club, Inc. v. Lawrence*, 29 N.C. App. 547, 225 S.E.2d 167, *cert. denied*, 290 N.C. 659, 228 S.E.2d 455 (1976).

63. 35 N.C. App. at 139, 240 S.E.2d at 507. It would seem, however, that, if the grantor had intended that the covenants be enforceable by the lot owners, the principles of agency, and not the express intent of the grantor, would determine whether those covenants might also be enforced by an agent of the lot owners. See note 64 and accompanying text *infra*.

64. Dean Cribbet notes: "The contemporary subdivision with its detailed set of covenants, *to be enforced by a Property Owners' Association rather than by individual owners*, has become a part of every community." J. CRIBBET, *supra* note 41, at 360 (emphasis added). Further, it has been argued that policing of covenants by a property owners' association is preferable to enforcement by individual owners because enforcement costs may then be equitably and uniformly shared by those benefiting from the covenants. See Ellickson, *Alternative to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681, 717 (1973).

65. Although the *Neponsit* court did find the assignment of enforcement rights to the property owners' association of some significance, it noted that the property owners' association had "not succeeded to the ownership of any property of the grantor," but instead was "created solely to act as the assignee of the benefit of the covenant," and had "no interest of its own in the enforcement of the covenant." 278 N.Y. at 260, 15 N.E.2d at 797. Therefore, the court did not base the property owners' association's right of enforcement upon the express assignment of those rights by the grantor, rather, the requisite privity of estate existed because the property owners' association had been formed to act and was acting as the "agent or representative of the Neponsit property owners." *Id.* at 261-62, 15 N.E.2d at 797-98. The court in *Current* found that the POA could not draw upon the property interests of the lot owners in establishing privity of estate because the POA "is a corporation and, as such, must be viewed as an entity distinct from its individual members." 35 N.C. App. at 139, 240 S.E.2d at 507. See also *Troy Lumber Co. v. Hunt*, 251 N.C. 624, 112 S.E.2d 132 (1960). The court in *Neponsit*, on the other hand, while not ignoring the corporate form of the property owners' association, looked behind that form to recognize the association as an agent of the owners. 278 N.Y. at 262, 15 N.E.2d at 798. While the court of appeals in *Current* found that the express provision for enforcement by the property owners' asso-

[o]nly blind adherence to an ancient formula devised to meet entirely different conditions could constrain the court to hold that a corporation formed as a medium for the enjoyment of common rights of property owners . . . has no cause of action in equity to enforce the covenant upon which such common rights depend.⁶⁶

With its decision in *Raintree Corp. v. Rowe*,⁶⁷ the court of appeals cast doubt on its earlier decision in *Current* and further confused the North Carolina law on enforcement of covenants. An assignee of the original subdivision developer brought suit to collect unpaid maintenance assessments and country club dues from defendant property owners.⁶⁸ The trial court dismissed the action, holding that the property owners' association (POA) and the country club, as the real parties in interest, were the only ones entitled to enforce these claims.⁶⁹

The court of appeals held that because the covenant establishing the maintenance assessment, as well as the bylaws of the POA, required that the assessment be paid to the POA, the covenant was intended to benefit the POA. Plaintiff, therefore, was not the proper party to enforce a claim for the assessment.⁷⁰ Turning to the claim for country club dues, the court stated that the real party in interest was the party who had a substantive legal right to enforce the claim.⁷¹ The court first found that the covenant created an "affirmative duty" to pay a collateral sum of money that did not "touch and concern" the land. The covenant did not, therefore, run with the land so as to be enforceable by anyone other than the original parties to the promise.⁷² Having held

ciation made the *Nepositi* deeds "a model of clarity in comparison with the provisions in the Beech Mountain deeds," 35 N.C. App. at 139, 240 S.E.2d at 507, it would seem that the intention that the POA enforce the covenant to pay assessments as an agent of and for the benefit of the owners is no less implicit in the covenants viewed as a whole.

66. 278 N.Y. at 262, 15 N.E.2d at 798.

67. 38 N.C. App. 664, 248 S.E.2d 904 (1978).

68. *Id.* at 665, 248 S.E.2d at 906. All lots in the subdivision were conveyed subject to restrictive covenants, which in pertinent part provided:

(1) property owners have rights of enjoyment in common areas, (2) each owner and each subsequent owner covenants to pay assessments for maintenance of common areas and other purposes by accepting a deed, (3) every owner is a mandatory member of Raintree Country Club and must pay club dues, (4) unpaid maintenance assessments and unpaid club dues subject the owner's lot to a lien.

Id. at 665-66, 248 S.E.2d at 906.

69. *Id.* at 666, 248 S.E.2d at 906. See N.C.R. Civ. P. 17.

70. 38 N.C. App. at 668, 248 S.E.2d at 907.

71. *Id.*; see *Reliance Ins. Co. v. Walker*, 33 N.C. App. 15, 19, 234 S.E.2d at 206, 209 (1977).

72. 38 N.C. App. at 669-71, 248 S.E.2d at 907-09. The traditional requirements that must be met for a covenant to run with the land, and thus be enforceable by those other than the original parties to the promise, are: (1) form, (2) intention of the parties, (3) a promise that "touches and concerns" the land, and (4) privity of estate. See C. CLARK, *REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH LAND"* 94 (2d ed. 1947). The requirement of intent can most easily

the covenant to be a personal one, the court of appeals concluded that such covenants are not assignable and plaintiff, as an assignee of the original grantor, could not enforce the covenant to pay country club dues.⁷³

The court's decision can be criticized for several reasons. First, while it is unquestioned that a property owners' association may enforce a covenant to pay assessments,⁷⁴ it does not follow that an assignee of the original developer may not also enforce the promise. Having succeeded to the estate of the original grantor, an assignee is generally held to be entitled to enforce the covenants that the grantor

be met by a statement to the effect that "these covenants shall run with the land." J. CRIBBET, *supra* note 41, at 354; see *Lamica v. Gerdes*, 270 N.C. 85, 88, 153 S.E.2d 814, 816 (1967). In the absence of an express provision, the requisite intent may be inferred in North Carolina from a "general plan of development." J. WEBSTER, *supra* note 4, § 346, at 438. The developer in *Raintree Corp.* took the former course. See 38 N.C. App. at 669, 248 S.E.2d at 908. Even if intent is established, however, the covenant will not run with the land unless the two remaining requirements are met. See J. CRIBBET, *supra* note 41, at 354.

The court in *Raintree Corp.* adopted a restrictive test of the "touch and concern" requirement; the covenant "must respect the thing granted or devised, and . . . the act covenanted to be done or omitted, must concern the lands or estate conveyed." 38 N.C. App. at 670, 247 S.E.2d at 438 (quoting *Nesbit v. Nesbit*, 1 N.C. 490, 495 (1801)). This test, adopted from a decision rendered about the turn of the nineteenth century, says little and should be rejected. A more workable test, proposed by Professor Bigelow, measures the effect of the covenant upon the legal relations of the parties in their status as owners of the land in question, and not merely as members of the community generally. Under this test if the value of the parties' respective legal interests in the property affected by the covenants is increased or decreased by the promise, the covenant "touches and concerns" the land. See Bigelow, *The Content of Covenants in Leases*, 12 MICH. L. REV. 639, 645-46 (1914). This test "has the merit of realism" and "is based on the effect of the covenant rather than on technical distinctions." *Neponsit Property Owners' Ass'n v. Emigrant Indus. Sav. Bank*, 278 N.Y. at 257, 15 N.E.2d at 796. *Contra*, Berger, *A Policy Analysis of Promises Respecting the Use of Land*, 55 MINN. L. REV. 167, 211 (1970). While the court in *Raintree Corp.* seems to require that under the *Nesbit* test a physical nexus exist between the benefit to be derived from the promise to pay country club dues and the promisor's land, see 38 N.C. App. at 670, 247 S.E.2d at 438, it could easily have found under the modern "legal relations" test that the promise touched and concerned the land.

Although the court in *Raintree Corp.* did not reach the question, it is clear that the assignee of the original grantor could have established privity of estate. Although this test has been defined in several ways, Clark has pointed out that it is valid only in the "sense of succession to the state of a party to the covenant." C. CLARK, *supra* at 131-37. Further, it is the rule in North Carolina that "[a]s between the original parties to the covenants and those owning title by *mesne* conveyances from them, restrictive covenants are enforceable irrespective of any general scheme of development." J. Webster, *supra* note 4, § 346, at 438; see *Starmount Co. v. Greensboro Memorial Park, Inc.*, 233 N.C. 613, 65 S.E.2d 134 (1951).

73. 38 N.C. at 671, 248 S.E.2d at 909; see *McCotter v. Barnes*, 247 N.C. 480, 486, 101 S.E.2d 330, 335 (1958); *Maples v. Horton*, 239 N.C. 394, 399, 80 S.E.2d 38, 42 (1954).

74. See *Merrionette Manor Homes Improvement Ass'n v. Heda*, 11 Ill. App. 2d 186, 136 N.E.2d 556 (1956); *Neponsit Property Owners' Ass'n v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938). But see *Beech Mountain Property Owners' Ass'n v. Current*, 35 N.C. App. 135, 241 S.E.2d 182 (1978). It is not clear whether this case remains a valid precedent after the holding in *Raintree Corp.*

received from his grantees.⁷⁵ Further, the assignee of the original developer, as the owner of lots still to be sold, should be entitled to enforce common covenants against other lot owners.⁷⁶ Finally, under a more liberal reading of the "touch and concern" requirement,⁷⁷ covenants to pay assessments and dues have been enforced as covenants running with the land.⁷⁸

Although *Current* and *Raintree Corp.* reflect the North Carolina courts' traditional view that "[c]ovenants and agreements restricting the free use of property are strictly construed against limitations upon such use" ⁷⁹ in light of society's acceptance of the restrictive covenant as "an essential tool in private land use control,"⁸⁰ the time has come to revise this conservative attitude.⁸¹ At their best the two decisions represent a muddying of the waters concerning enforcement of restrictive covenants. At their worst they appear to be a concerted effort to preserve eighteenth century property concepts that can only serve to inhibit private development in North Carolina.

75. See J. WEBSTER, *supra* note 4, § 346, at 437-38; *accord*, *Snowmass American Corp. v. Schoenheit*, 524 P.2d 645 (Colo. App. 1974).

76. See *Sheets v. Dillon*, 221 N.C. 426, 431, 20 S.E.2d 344, 347-48 (1942).

77. For a discussion of the "legal relations" test, see note 72 *supra*.

78. See *Merrionette Manor Homes Improvement Ass'n v. Heda*, 11 Ill. App. 186, 136 N.E.2d 556 (1956); *Neponsit Property Owners' Ass'n v. Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938).

The inference to be drawn from the court of appeals' divergent treatment in *Raintree Corp.* of a covenant to pay a maintenance assessment and one to pay country club dues is that the former is sufficiently related to the ownership of land in a subdivision to permit enforcement by a stranger to the covenant, while the latter lacks the physical nexus and thus should only be enforceable as a personal covenant. A covenant to pay country club dues, however, does undoubtedly enhance the value of lots in a subdivision by assuring prospective buyers and other lot owners that funds for the maintenance of country club facilities will be forthcoming. Moreover, while such a charge reduces the value of the homeowner's interest in his lot, this reduction should be offset by the benefit that inures to the homeowner from the common promise of other grantees within the subdivision that they will pay their country club dues. Thus, it is apparent that the covenant to pay country club dues does meet the "legal relations" test of a promise that "touches and concerns" the land and should be enforceable by those who receive some benefit from the promise, *i.e.*, the developer, the country club and other lot owners. Although the *Raintree Corp.* court believed that it would be unfair to impose a charge for country club facilities upon a homeowner who might never use them, 38 N.C. App. at 670, 248 S.E.2d at 908, it would seem that a homeowner, in purchasing a lot with record notice of the covenant, impliedly consents to payment of the dues notwithstanding his nonuse of the facilities.

79. *Long v. Branham*, 271 N.C. 264, 268, 156 S.E.2d 235, 239 (1967) (quoting 20 AM. JUR. 2d *Covenants, Conditions and Restrictions* § 187 (1965)); *accord*, *Starmount Co. v. Greensboro Memorial Park, Inc.*, 233 N.C. 613, 65 S.E.2d 134 (1951); *Edney v. Powers*, 224 N.C. 441, 31 S.E.2d 372 (1944). Even this view, however, is tempered by the statement that "[t]he strict rule of construction as to restrictions should not be applied in such a way as to defeat the plain and obvious purposes of a restriction." *Long v. Branham*, 271 N.C. 264, 268, 156 S.E.2d 235, 239 (1967) (quoting 20 AM. JUR. 2d, *Covenants, Conditions and Restrictions* § 187 (1965)).

80. J. CRIBBET, *supra* note 41, at 360.

81. See *Dunham, Promises Respecting the Use of Land*, 8 J.L. ECON. 133, 162-65 (1965).

In *Mills v. HTL Enterprises, Inc.*,⁸² the court of appeals stiffened the requirements for terminating a restrictive covenant. Plaintiff lot owners brought suit to enforce a covenant restricting all lots in a subdivision to residential use against defendant lot owner who intended to use its lot as a parking area for an adjacent retail fried chicken outlet.⁸³ The lot in question was located at the corner of a major commercial thoroughfare and a residential street running through the subdivision, and marked the southern boundary of the covenanted area. It had previously served for a number of years as a parking lot for a plumbing company and a candle shop, this use being acquiesced in by the adjoining lot owners.⁸⁴ The trial court found that, because of the fundamental, radical and substantial changes that the neighborhood had undergone since the imposition of the covenant, the covenant no longer served its purpose in relation to the lot in question, but rather rendered the lot virtually useless and worthless. The court concluded, therefore, that the covenant should be removed.⁸⁵

The court of appeals reversed and held that "the encroachment of business and changes due thereto, in order to undo the force and vitality of the restrictions, must take place *within* the covenanted area."⁸⁶ The court further held that the parking previously allowed on the lot was not "significant enough to undo the force and validity of the restrictions . . . or to constitute a waiver or an estoppel of plaintiffs' right to enforce the covenants."⁸⁷

The decision in *Mills* represents a stiffening of conditions necessary to terminate an outmoded restriction. Although the North Carolina courts have generally refused to find that changes occurring outside the restricted area are sufficient to warrant a removal of the restriction,⁸⁸ when there have been "changed conditions within the covenanted area, acquiesced in by the owners to such an extent as to

82. 36 N.C. App. 410, 244 S.E.2d 469, *cert. denied*, 295 N.C. 551, 248 S.E.2d 727 (1978).

83. *Id.* at 410-11, 244 S.E.2d at 470.

84. 36 N.C. App. at 411-15, 244 S.E.2d at 470-72.

85. *Id.* at 415-16, 244 S.E.2d at 472-73. At the time the restrictions were imposed, 37 years earlier, the area was a residential one lying just inside the Charlotte city limits, but at the time of suit the surrounding neighborhood had become largely commercial. *Id.* at 413-15, 244 S.E.2d at 471-72.

86. *Id.* at 419-20, 244 S.E.2d at 475 (quoting *Brenizer v. Stephens*, 220 N.C. 395, 399, 17 S.E.2d 471, 473 (1941)).

87. 36 N.C. App. at 417-18, 244 S.E.2d at 473-74.

88. *See, e.g.*, *Tull v. Doctor's Bldg., Inc.*, 255 N.C. 23, 120 S.E.2d 817 (1961); *Brenizer v. Stephens*, 220 N.C. 395, 17 S.E.2d 471 (1941). *Contra*, *Muilenberg v. Blevins*, 242 N.C. 271, 87 S.E.2d 493 (1955); *Elrod v. Phillips*, 214 N.C. 472, 199 S.E. 722 (1938).

constitute a waiver or abandonment' ”⁸⁹ the courts have usually removed the restriction.⁹⁰ The change in *Mills* occurred not only in the surrounding area but extended to the lot in question as well. Further, in previous cases finding an absence of waiver, the use acquiesced in by the adjoining owners was far more in keeping with the residential character of their neighborhoods.⁹¹ While lot owners may understandably wish to preserve a buffer zone between their homes and commercial development, they should not be allowed to do so at the expense of one who purchases in reasonable reliance on their apparent acquiescence in such development. In view of the decision in *Mills*, those who purchase a lot or tract for commercial use should carefully check the chain of title for possible restrictions and disregard any former use of the property.⁹²

C. *Disputed Ownership*⁹³

The North Carolina Court of Appeals in *Garrison v. Blake-*

89. *Tull v. Doctor's Bldg., Inc.*, 255 N.C. 23, 40, 120 S.E.2d 817, 829 (1961) (quoting *Vernon v. R.J. Reynolds Realty Co.*, 226 N.C. 55, 61, 36 S.E.2d 710, 712 (1946)).

90. *Shuford v. Asheville Oil Co.*, 243 N.C. 636, 91 S.E.2d 903 (1956); *Bengel v. Barnes*, 231 N.C. 667, 58 S.E.2d 371 (1950).

91. *See Tull v. Doctor's Bldg., Inc.*, 255 N.C. 23, 120 S.E.2d 817 (1961) (parking lot for doctor's office); *Van Poole v. Messer*, 25 N.C. App. 203, 212 S.E.2d 548 (1975) (single house trailer); *Sterling Cotton Mills, Inc., v. Vaughan*, 24 N.C. App. 696, 212 S.E.2d 199 (1975) (concession stand in home).

The *Mills* court feared that the removal of restrictions on border lots would subject the lots next inside to the same process until “the restrictions throughout the tract” became “nugatory through a gradual infiltration of the spreading change.” 36 N.C. App. at 419, 244 S.E.2d at 474 (quoting *Tull v. Doctor's Bldg., Inc.*, 255 N.C. at 40, 120 S.E.2d at 829). Even under a more liberal rule, however, such a process could easily be avoided if the lot owners would refuse to permit any further nonresidential use of the lots within the subdivision.

92. A further development in the law as it relates to residential restrictions was *Harris & Gurganus, Inc. v. Williams*, 37 N.C. App. 585, 246 S.E.2d 791 (1978), a case of first impression in which the court of appeals held that a covenant to build a house within a specified time or reconvey was valid if enforced within a reasonable time after the failure to build. Although the court found scant authority for its position, *id.* at 587, 246 S.E.2d at 793-94, a promise to reconvey has been held valid, *Felton v. Grier*, 109 Ga. 320, 35 S.E. 175 (1900), and a number of cases have found a covenant to build enforceable, *see, e.g., Sayles v. Hall*, 210 Mass. 281, 96 N.E. 712 (1911); *Baumert v. Malkin*, 235 N.Y. 115, 139 N.E. 210 (1923). While such covenants are generally considered a form of residential restriction, *Annot.*, 32 A.L.R.2d 1209 (1953), in light of the fact that they are only enforceable by the grantor, a direct restriction to residential use would appear to be more effective.

93. In 1978 the North Carolina Court of Appeals held in *Wadsworth v. Georgia-Pacific Corp.*, 38 N.C. App. 1, 247 S.E.2d 25 (1978), that parol evidence is competent to prove the location of a disputed boundary line, even though neither party attempted to first locate the boundary line from calls in the deeds. This is apparently the first North Carolina decision permitting use of parol evidence absent a showing that the deeds are insufficient to locate the boundary. For cases not permitting parol evidence in this situation, *see Taylor v. Meadows*, 175 N.C. 373, 95 S.E. 662 (1918); *Wiggins v. Rogers*, 175 N.C. 67, 94 S.E. 685 (1917); *Kirkpatrick v. McCracken*, 161 N.C. 198, 76 S.E. 821 (1912). The court apparently based its holding on the distinction that neither party offered a deed in evidence. 38 N.C. App. at 5, 247 S.E.2d at 27.

Further, the court of appeals in *North Carolina Nat'l Bank v. Evans*, 35 N.C. App. 322, 241

ney⁹⁴ examined the requirement of proving a seal to validate a deed. Petitioners appealed a trial court determination in favor of respondents' claim to ownership of a parcel of land involved in a partition proceeding, alleging that a deed in respondents' chain was void for lack of a seal.⁹⁵

Although the court of appeals recognized that "the reason for the use of a seal—the authentication of the grantor—has long since been completely eliminated in this State," it concluded that, in the absence of a legislative abrogation of this requirement, a seal remains essential to the validity of a deed in North Carolina.⁹⁶ The deed in *Garrison* ended with this handwritten statement: "In token where of I do hereto this thirteenth day of February 1917 fix my sign and seal."⁹⁷ The grantor's signature appeared immediately below this statement and opposite the word "Sign."⁹⁸ The court noted that the word "Sign" could include the words "Sign and Seal" appearing above it because "any mark or scrawl may be a seal if proved to be a seal."⁹⁹ It held, nevertheless, that while the trial court might conclude as a matter of law that the word "Sign" constituted a seal, there remained a question of fact about whether the grantor placed it there, or adopted it as his seal if placed there by someone else.¹⁰⁰

Because most seals are now printed rather than handwritten, the decision in *Garrison* raises the specter of numerous challenges to the

S.E.2d 379 (1978), held that a conveyance was not "voluntary" so as to constitute a fraudulent conveyance when there was any legal consideration, and that adequacy of consideration was irrelevant when there was no allegation of fraud on the part of the grantor. The dissent argued persuasively that although consideration may be "adequate" to support the deed as between the parties, it may still be fraudulent in respect of creditors. *Id.* at 327, 241 S.E.2d at 382 (dissenting opinion). The decision is apparently contrary to prior North Carolina holdings. *See, e.g.,* L & M Gas Co. v. Leggett, 273 N.C. 547, 161 S.E.2d 23 (1968).

An additional development in 1978 was the holding of the United States Court of Appeals for the Fourth Circuit in *King v. United States*, 585 F.2d 1213 (4th Cir. 1978), that, in resolving an issue of untimeliness in an action to quiet title under 28 U.S.C. § 2409a (1976), the same rules that govern the establishment of title by adverse possession under North Carolina law shall apply in determining whether a party knew or should have known of the defendant's claim.

94. 37 N.C. App. 73, 246 S.E.2d 144, *cert. denied*, 295 N.C. 646, 248 S.E.2d 251 (1978).

95. *Id.* at 78, 246 S.E.2d at 147.

96. *Id.* at 79, 246 S.E.2d at 148; *see* *Williams v. Board of Educ.*, 284 N.C. 588, 201 S.E.2d 889 (1974); *Williams v. Turner*, 208 N.C. 202, 179 S.E. 806 (1935); *Patterson v. Galliher*, 122 N.C. 511, 29 S.E. 773 (1898).

97. 37 N.C. App. at 80, 246 S.E.2d at 148.

98. *Id.*

99. *Id.* at 81, 246 S.E.2d at 149. Professor Webster criticized the efficacy of the rule requiring a seal for this very reason. *See* J. WEBSTER, *supra* note 4, § 170, at 198-99 n.184.

100. 37 N.C. App. at 81, 246 S.E.2d at 149; *see* *Williams v. Turner*, 208 N.C. 202, 179 S.E. 806 (1935); *Pickens v. Rymer*, 90 N.C. 282 (1884); *Yarborough v. Monday*, 14 N.C. 420 (1832).

validity of deeds with the consequent difficulty of proving that the grantor adopted the seal.¹⁰¹ This apprehension should be allayed, however, by the *Garrison* court's further reaffirmation of the rule that when the deed is a form deed and the printed word "seal" appears in parentheses opposite the grantor's signature, there is a presumption that the grantor intended to adopt the seal.¹⁰² Because most conveyances today are made by form deed, the decision will probably affect few cases. It is significant, however, as a reflection of the problems created by adherence to the rule requiring a seal for a valid deed. Many states have abolished the rule,¹⁰³ and the General Assembly should heed the counsel of the bar and the courts and lay the rule to rest in North Carolina.

In *Faucette v. Griffin*¹⁰⁴ plaintiff brought an action to quiet title, claiming superior title from a common source.¹⁰⁵ Defendant contended that one of the conveyances in plaintiff's chain of title had been made by a married woman during coverture without the assent of her husband, and, therefore, was invalid under the constitutional provisions then in effect.¹⁰⁶ Plaintiff countered that the deed was validated by G.S. 39-7.1,¹⁰⁷ which purports to validate all conveyances made prior to 1965 by a married woman of her separate property without the joinder of her husband.¹⁰⁸

The court of appeals reversed the judgment in favor of plaintiff because she had failed to fit her chain of title to the description in the deed from the common source.¹⁰⁹ The court indicated, however, that, were the question presented to it in a proper case, it would invalidate G.S. 39-7.1 because "[a] void contract cannot be validated by a subsequent act, and the Legislature has no power to pass acts affecting vested rights."¹¹⁰

The decision in *Faucette* demonstrates a trend on the part of the

101. See UNITED TITLE INSURANCE COMPANY BULLETIN, OCT. 16, 1978 (copy available from United Title Insurance Co., P.O. Box 1920, Raleigh, N.C. 27602).

102. 37 N.C. App. at 84, 246 S.E.2d at 150; see *McGowan v. Beach*, 242 N.C. 73, 86 S.E.2d 763 (1955).

103. See J. WEBSTER, *supra* note 4, § 170, at 198-99 n.184.

104. 35 N.C. App. 7, 239 S.E.2d 712, *cert. denied*, 294 N.C. 736, 244 S.E.2d 154 (1978).

105. *Id.* at 7-9, 239 S.E.2d at 712-13; see *Mobley v. Griffin*, 104 N.C. 112, 10 S.E. 142 (1889).

106. 35 N.C. App. at 11, 239 S.E.2d at 714; see *Buford v. Mochy*, 224 N.C. 235, 29 S.E.2d 729 (1944).

107. N.C. GEN. STAT. § 39-7.1 (1976).

108. 35 N.C. App. at 11-12, 239 S.E.2d at 714-15.

109. 35 N.C. App. at 10-11, 239 S.E.2d at 714; see *Allen v. Conservative Hunting Club*, 14 N.C. App. 697, 700, 189 S.E.2d 532, 534 (1972).

110. 35 N.C. App. at 12, 239 S.E.2d at 715 (quoting *Mansour v. Rabil*, 277 N.C. 364, 376, 177 S.E.2d 849, 857 (1970)).

North Carolina courts to invalidate curative acts that affect vested rights.¹¹¹ Although curative acts are a laudable attempt on the part of the legislature to remove the technicalities that often create problems of merchantability of title,¹¹² the decision in *Faucette* casts doubt on the constitutionality of such measures and reliance on them should be avoided.¹¹³

In *Meachem v. Boyce*,¹¹⁴ the court of appeals required the joinder in a partition proceeding of those parties who might claim an interest in the land by virtue of an unasserted right of estoppel by deed. The subject property in *Meachem* had formerly been held by the parties as tenants by the entirety, but that estate was converted to a tenancy in common upon the divorce of the parties.¹¹⁵ During the marriage, the petitioning former wife had, without the joinder of her husband, executed a deed of trust on the property and attempted to convey it to a third party.¹¹⁶ The trial court, nevertheless, ordered a sale of the property and partition of the proceeds between the former spouses.¹¹⁷ Respondent former husband appealed, contending that the parties to the wife's two purported conveyances during the marriage should have been joined in the action.¹¹⁸ The court of appeals held that these parties were necessary parties to a partition proceeding¹¹⁹ because while their unasserted rights to an interest in the property by virtue of estoppel by deed would be terminated by a sale to a purchaser for value,¹²⁰

111. *Mansour v. Rabil*, 277 N.C. 364, 177 S.E.2d 849 (1970) invalidated N.C. GEN. STAT. § 39-13.1(b) (1976), purporting to validate all deeds executed prior to February 7, 1945 by married women who had not been privately examined. See also *Booth v. Hairston*, 193 N.C. 278, 136 S.E. 879 (1927).

112. See, e.g., N.C. GEN. STAT. §§ 47-47 to -108.17 (1976 & Supp. 1977).

113. A notable exception to this statement is the Real Property Marketable Title Act, N.C. GEN. STAT. §§ 47B-1 to -9 (1976). The constitutionality of this Act is apparently assured by § 47B-4, which permits those having extinguishable claims to re-record them. See Note, *Property Law—North Carolina's Marketable Title Act—Will the Exceptions Swallow the Rule?*, 52 N.C.L. REV. 211, 220 (1973).

114. 35 N.C. App. 506, 241 S.E.2d 880 (1978).

115. See J. WEBSTER, *supra* note 4, § 116.

116. 35 N.C. App. at 507, 241 S.E.2d at 881. In North Carolina an attempted conveyance by either spouse, acting alone, of entirety property is invalid. It is converted, however, under the case law, into a contract to convey and upon the termination of the marriage relation by divorce or the death of the other spouse, the third party may assert principles of estoppel by deed against the spouse who attempted to convey and attempt to enforce the contract. See *Harrell v. Powell*, 251 N.C. 636, 112 S.E.2d 81 (1960). See also *Cruthis v. Steele*, 259 N.C. 701, 131 S.E.2d 344 (1963).

117. 35 N.C. App. at 508, 241 S.E.2d at 881.

118. *Id.*, 241 S.E.2d at 882.

119. *Id.* at 511, 241 S.E.2d at 883. "Necessary parties are those persons who have rights which must be ascertained and settled before the rights of the parties to the suit can be determined." *Equitable Life Assurance Soc'y v. Basnight*, 234 N.C. 347, 352, 67 S.E.2d 390, 395 (1951).

120. See *Builders' Sash & Door Co. v. Joyner*, 182 N.C. 518, 109 S.E. 259 (1921).

the mere presence of such rights might have an adverse effect on the sale price.¹²¹

The court in *Meachem* looked beyond legal distinctions to achieve an equitable result. Although it realized that an unasserted right to estoppel by deed would be extinguished by the partition sale, it also recognized that such an interest might, in the eyes of a purchaser, constitute a potential cloud on title and, therefore, lower the price bid. The *Meachem* decision should serve to avoid the prejudice to an innocent spouse that might result from the illegal acts of the other spouse in attempting to convey their joint interest in entirety property.

D. Eminent Domain¹²²

In *Berta v. Highway Commission*,¹²³ the North Carolina Court of Appeals for the first time addressed the question when title vests in the Board of Transportation under G.S. 136-111,¹²⁴ the inverse condemnation¹²⁵ provision, for the purpose of allocating the condemnation award between the original owner of the land and his grantee. Plaintiff Berta brought an inverse condemnation action under G.S. 136-111 in which he alleged that defendant's construction of Interstate Highway 26 had caused severe water, silt, and gravel run-off onto his land.¹²⁶ Three years later plaintiff conveyed a portion of this land to appellant grantees who subsequently sought to intervene to claim damages for injury to their parcel.¹²⁷ The lower court denied the motion to intervene, and the court of appeals affirmed, finding that appellants had not lost a compensable interest in the property.¹²⁸

121. 35 N.C. App. at 511-12, 241 S.E.2d at 883-84.

122. In *Board of Transp. v. Jones*, 38 N.C. App. 337, 248 S.E.2d 108 (1978), the court of appeals found that the trial court erred in failing to instruct the jury that they were to consider both general and special benefits to the portion of the tract not taken when determining the amount of damages for a partial taking under N.C. GEN. STAT. § 136-112(1) (1974).

123. 36 N.C. App. 749, 245 S.E.2d 409 (1978).

124. N.C. GEN. STAT. § 136-111 (1974). The statute provides in part: "Any person whose land or compensable interest therein has been taken by an intentional or unintentional act or omission of the Board of Transportation and no complaint and declaration of taking has been filed by said Board of Transportation [may make a claim for compensation]."

125. The legal doctrine indicated by the term, "inverse condemnation," is well established in this jurisdiction. Where private property is *taken* for a public purpose by a municipality or other agency having the power of eminent domain under circumstances such that no procedure provided by statute affords an applicable or adequate remedy, the owner, in the exercise of his constitutional rights, may maintain *an action* to obtain just compensation therefor.

City of Charlotte v. Spratt, 263 N.C. 656, 663, 140 S.E.2d 341, 346 (1965) (emphasis in original).

126. 36 N.C. App. at 750-51, 245 S.E.2d at 410.

127. *Id.*

128. *Id.* at 751, 754, 245 S.E.2d at 410, 412.

Appellants' argument turned on the difference in the language of G.S. 136-111¹²⁹ and G.S. 136-104¹³⁰ the condemnation provision. When the Board of Transportation institutes a condemnation action under G.S. 136-104, title vests in the Board upon satisfaction of the statutory requirements.¹³¹ G.S. 136-111, however, does not contain a similar provision on vesting of title. Therefore, appellants claimed that under G.S. 136-111 title could not vest in the Board until final judgment and payment of compensation and that because they had intervened before final judgment, they were deprived of a compensable interest.¹³²

The court of appeals, however, adopted the interpretation of the statute advanced by defendant: when an owner brings an action under G.S. 136-111 for inverse condemnation, the taking has already occurred.¹³³ The court found this view to be consistent with the language of the statute that speaks of land or an interest that "has been taken" although no complaint and declaration of taking "has been filed" by the Board of Transportation.¹³⁴ Therefore, because the land was "taken" before plaintiff transferred the tract to appellants, injury was inflicted upon plaintiff alone; appellants took the land subject to the already present damage.¹³⁵ This interpretation of the statute accords with the accepted rule that the right to a condemnation award belongs to the vendor and does not inure to the benefit of the vendee when the land is sold after the taking.¹³⁶

129. Quoted in note 124 *supra*.

130. N.C. GEN. STAT. § 136-104 (1974); see 36 N.C. App. at 752-53, 245 S.E.2d at 411.

131. N.C. GEN. STAT. § 136-104 (1974) pertinent provides in part:

Upon the filing of the complaint and the declaration of taking and deposit in court, . . . of the amount of the estimated compensation stated in the declaration, title to said land or such other interest therein specified . . . together with the right to immediate possession hereof shall vest in the Board of Transportation

132. 36 N.C. App. at 752-53, 245 S.E.2d at 411.

133. *Id.* at 753, 245 S.E.2d at 411.

134. *Id.*

135. *Id.* at 754, 245 S.E.2d at 411-12.

136. The rationale for the rule is that any "condemnee owner is only entitled to be indemnified to the extent that he has *lost* by the taking." J. WEBSTER, *supra* note 4, § 360, at 485 (emphasis in original). Here appellants had not "lost" anything because the taking occurred before the land was conveyed to them.

The rule is stated in 2 P. NICHOLS, THE LAW OF EMINENT DOMAIN § 5.21, at 48-52 (rev. 3d ed. 1978):

If a parcel of land is sold after a portion of it has been taken (or after it has been injuriously affected by the construction of some authorized public work), the right to compensation, constitutional or statutory, does not run with the land but remains a personal claim in the hands of the vendor, unless it has been assigned by special assignment or by a provision in the deed. It is immaterial that the question of compensation is deferred. Conversely, if the land is sold after condemnation proceedings have been instituted, but

The result is well founded both in terms of statutory construction and in terms of fairness to the parties. Indeed, as defendant argued, there would be no basis for an inverse condemnation action under G.S. 136-111 unless a prior taking had occurred. Any damages arising from that taking properly should go to the owner at the time, and not to any subsequent grantee. Failure to follow the rule articulated by the court would cause an undeserved loss to the original owner and an undeserved gain to the vendee.¹³⁷

In *Board of Transportation v. Martin*,¹³⁸ the North Carolina Supreme Court in a case of first impression confronted the question whether there is unity of ownership for the purpose of considering two parcels of land as a unit in the determination of a condemnation award when one parcel is owned jointly by two individuals and the other is owned by a corporation whose sole shareholder is one of the individuals. A portion of a parcel jointly owned by defendant and his wife was condemned; the other parcel at issue was contiguous to this and was owned by a shopping center corporation of which the defendant husband was the sole shareholder.¹³⁹ Prior to the taking by plaintiff, defendants had decided to expand the shopping center onto the parcel owned by them as individuals.¹⁴⁰ Initial preparations for the expansion were made.¹⁴¹ The trial court held that the two parcels comprised a unity for damages purposes, but the supreme court found no unity of ownership, vacated the judgment and remanded.¹⁴²

The supreme court invoked the three requirements for unity of lands in eminent domain proceedings stated in *Barnes v. North Carolina State Highway Commission*:¹⁴³ "unity of ownership, physical unity and

before the *punctum temporis* of the taking, the purchaser, and not the vendor, is entitled to the compensation unless the right to receive [*sic*], the compensation is expressly reserved by the vendor, or the vendee has waived his rights in favor of the vendor.

The court also held that appellants did not make a timely motion to intervene in the action because they did not intervene at the initial hearing but waited instead to intervene at the damages hearing. 36 N.C. App. at 754-55, 245 S.E.2d at 412. See generally N.C.R. Civ. P. 24.

137. See *Brooks Inv. Co. v. City of Bloomington*, 305 Minn. 305, 315, 232 N.W.2d 911, 918 (1975).

138. 296 N.C. 20, 249 S.E.2d 390 (1978).

139. *Id.* at 21-22, 249 S.E.2d at 392. Defendants incorporated the shopping center in order to facilitate financing of the venture. At the time of the taking, the shopping center corporation was involved in Chapter X bankruptcy proceedings. *Id.* at 22, 24, 249 S.E.2d at 392-93.

140. *Id.* at 23, 249 S.E.2d at 393.

141. Defendants had introduced water and utility services and had had a large area graded. *Id.*

142. *Id.* at 24, 30, 249 S.E.2d at 394, 397.

143. 250 N.C. 378, 109 S.E.2d 219 (1959).

unity of use.”¹⁴⁴ The *Barnes* court defined unity of ownership as ownership “by the same party or parties.”¹⁴⁵ The problem thus faced by the court was whether an individual and a corporation could constitute the “same party” to satisfy the *Barnes* test. Defendants argued that this unity did exist because the land owned by the corporation was in substance the same as the land owned by them as individuals, despite the different legal form of ownership.¹⁴⁶ The court, however, rejected the views of the New York¹⁴⁷ and New Jersey¹⁴⁸ authorities cited by defendants and accepted instead those advanced by plaintiff based on *Sams v. Redevelopment Authority*¹⁴⁹ and *Jonas v. State*.¹⁵⁰ In those two cases Pennsylvania and Wisconsin courts refused to disregard the corporate entity in order to benefit the individuals who were shareholders who wanted to establish unity of ownership to increase condemnation damages.¹⁵¹ Because the corporate entity has a separate legal existence

144. *Id.* at 384, 109 S.E.2d at 224-25. An owner attempts to establish that one or more parcels of land should be treated as a single tract in order to receive greater condemnation damages. See generally 4A P. NICHOLS, *supra* note 136, § 14.31[1]-[2] (rev. 3d ed. 1978); Annot., 95 A.L.R.2d 887 (1964). See also UNIFORM EMINENT DOMAIN CODE § 1007 which states:

For the purpose of determining compensation under this Article, all parcels of real property, whether contiguous or noncontiguous, that are in *substantially identical ownership* and are being used, or are reasonably suitable and available for use in the reasonably foreseeable future, for their highest and best use as an integrated economic unit, shall be treated as if the entire property constitutes a single parcel.

Id. at 97 (emphasis added).

145. 250 N.C. at 384, 109 S.E.2d at 225; cf. 4A P. NICHOLS, *supra* note 136, § 14.31[2], at 416 (“It is, of course, essential to constitute a single parcel that it be owned in its entirety by one owner or one set of owners.”).

146. 296 N.C. at 28, 249 S.E.2d at 396.

147. See *Erly Realty Dev., Inc. v. State*, 43 App. Div. 2d 301, 351 N.Y.S.2d 457 (1974), *appeal denied*, 34 N.Y.2d 515, 357 N.Y.S.2d 1025 (1974).

[T]he award of such [severance] damages has been sustained where, given contiguity and unity of use, close control of one ownership entity by the other is tantamount to actual ownership. . . . There was proof that the respective stock holdings of the individual claimants in the corporation were in exactly the same proportion as the undivided interest of each in the real estate of the individuals. Together, the individual claimants owned all the shares of the corporation.

Id. at 305, 351 N.Y.S.2d at 461-62 (citations omitted).

148. See *Housing Auth. v. Norfolk Realty Co.*, 71 N.J. 314, 364 A.2d 1052 (1976). The New Jersey court looked to “the unity of beneficial ownership of the whole.” *Id.* at 325, 364 A.2d at 1058.

149. 431 Pa. 240, 244 A.2d 779 (1968).

150. 19 Wis. 2d 638, 121 N.W.2d 235 (1963).

151. “It is difficult to conceive that a unity of use can exist when there are two separate and distinct legal entities operating each parcel of land. . . . Where there are two separate users (completely different entities) of the parcels involved, the use of both cannot be said to be so inseparable as to make them a unit for purposes of damages in a condemnation proceeding.”

Sams v. Redevelopment Auth., 431 Pa. at 243-44, 244 A.2d at 781 (holding that two parcels could not be considered a unit when one was owned by individuals as partnership and the other owned by corporation of which partners were sole shareholders).

from that of its shareholder owners,¹⁵² the court determined that the choice of a corporate legal form was binding on defendants and precluded a finding of unity of ownership when the only reason to pierce the corporate veil would be to allow defendants an economic benefit.¹⁵³

The *Martin* situation forced the court to choose between two conflicting policies. The first is that the corporation's status as a legal entity will not be disregarded absent a showing of good cause to pierce the corporate veil.¹⁵⁴ The second is that businessmen should be able to take advantage of various methods of asset ownership for economic and tax reasons without the risk of losing full damages in a condemnation taking.¹⁵⁵ By adopting a formalistic test that "a parcel of land owned by an individual and an adjacent parcel of land owned by a corporation of which that individual is the sole or principal shareholder cannot be treated as a unified tract for the purpose of assessing condemnation damages,"¹⁵⁶ the court asserted its belief in the preeminence of the first policy.

The North Carolina Court of Appeals in *Board of Transportation v. Charlotte Park & Recreation Commission*¹⁵⁷ dealt for the first time with a question of apportionment of a condemnation award between the holder of a fee simple subject to a condition subsequent and the holder of the right of re-entry or power of termination. The court affirmed the lower court decision that the owner of the possessory fee was entitled to the full award because there was no showing that the owner of the fee intended to renounce the limited use required by the deed.¹⁵⁸

The property at issue was conveyed by the Diocese of North Caro-

"In the present case, those who created the corporation in order to enjoy advantages flowing from its existence as a separate entity are asking that such existence be disregarded where it works a disadvantage to them. We do not consider it good policy to do so." *Jonas v. State*, 19 Wis. 2d at 644, 121 N.W.2d at 239 (holding that two parcels could not be considered a unit when one was owned by individuals and the other owned by a corporation of which one of individuals was principal shareholder).

152. See *Troy Lumber Co. v. Hunt*, 251 N.C. 624, 627, 112 S.E.2d 132, 134 (1960); 18 AM. JUR. 2d *Corporations* § 13 (1965).

153. 296 N.C. at 28, 249 S.E.2d at 395-96.

154. 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41, at 166 (rev. perm. ed. 1974).

155. *Housing Auth. v. Norfolk Realty Co.*, 71 N.J. 314, 324, 364 A.2d 1052, 1057 (1976).

156. 296 N.C. at 28, 249 S.E.2d at 396. See W. FLETCHER, *supra* note 154, § 41.2, at 180.

The court noted two additional problems with finding a unity of lands in *Martin*: title to the corporation's property was vested in the trustee in bankruptcy and there was no unity of use since one parcel was undeveloped and the other was used for a shopping center. 296 N.C. at 29-30, 249 S.E.2d at 396-97.

157. 38 N.C. App. 708, 248 S.E.2d 909 (1978), *cert. denied, appeal dismissed*, 296 N.C. 583 (1979).

158. *Id.* at 712, 248 S.E.2d at 912.

lina of the Protestant Episcopal Church (Diocese) to the Commission on the condition that it be used "for playground purposes" and that if the park were ever discontinued, the Commission had to offer to resell it to the Diocese for the original consideration.¹⁵⁹ The City of Charlotte initiated plans to condemn part of the property for street relocation; until that time the Commission had always maintained a park on the land.¹⁶⁰ The court first established that the Commission and the City were separate entities so that the City's decision to condemn did not trigger the condition of the deed and require the Commission to offer the property to the Diocese.¹⁶¹ The Diocese then claimed that it was entitled to a portion of the award nevertheless and contended that the court should follow the decision of the Minnesota Supreme Court in *State v. Independent School District No. 31*.¹⁶² In that case the court held that the owner of a possibility of reverter is always entitled to at least nominal damages when condemnation of the fee occurs and that substantial damages will accrue to the grantor in cases in which the fair market value of the restricted use in the deed is less than the fair market value of the highest practicable use.¹⁶³ The court of appeals, however, refused to adopt the Minnesota rule, and instead accepted the

159. *Id.* at 709, 248 S.E.2d at 910. The court did not analyze this conveyance but merely stated that it was a fee simple subject to a condition subsequent. This characterization would appear correct because the termination of the estate was not to occur automatically but rather the grantee was to tender an offer to purchase to the grantor. See J. WEBSTER, *supra* note 4, § 37, at 51-52.

160. 38 N.C. App. at 709, 248 S.E.2d at 910.

161. *Id.* at 710, 248 S.E.2d at 911. The Diocese contended that the City and Commission were substantively identical entities so that the City's decision to condemn the park for a street could be attributed to the Commission; thus, the Commission would violate the restrictive use of the deed and would entitle the Diocese to re-enter. *Id.*

A taking by eminent domain of a fee simple defeasible "does not . . . cause a reversion of the title to the grantor." *City of Charlotte v. Charlotte Park & Rec. Comm'n*, 278 N.C. 26, 32, 178 S.E.2d 601, 605 (1971). See 2 P. NICHOLS, *supra* note 136, § 5.221[1], at 73.

162. 266 Minn. 85, 123 N.W.2d 121 (1963), cited in 38 N.C. App. at 711, 248 S.E.2d at 912.

163. *Id.* at 95-97, 123 N.W.2d at 129. The court stated the measure of damages as follows:

If this value [value when used as provided in the conveyance of the fee simple determinable] is equal to or greater than the market value of the realty if used for other practicable purposes, the owner of the fee simple determinable is entitled to the full amount of the award less some nominal amount—1 percent of the sum awarded, for example—to be allocated to the owner of the possibility of reverter. If the value so fixed, in cases where abandonment of the use is imminent or where the realty would have a greater market value if devoted to some other practicable purpose, is less than the totality of the value, the owner of the possibility of reverter shall be entitled to a proportion of the condemnation award expressed by a fraction the denominator of which is the market value of the realty when devoted to its best practicable use and the numerator of which is the difference between such value and the value of the realty applied to the use to which it is restricted by the terms of the deed for such period of time as such use is reasonably to be anticipated.

Id. at 97, 123 N.W.2d at 130 (emphasis in original).

majority view that if the occurrence of the condition upon which the defeasible fee will terminate or which will trigger the re-entry rights of the grantor is not probable or imminent at the time of the institution of the eminent domain action, the entire award will go to the owner of the possessory fee simple defeasible.¹⁶⁴

The court failed to delineate its reasons for adopting the majority rule. Its focus on the grantee's lack of intention to abandon the restricted use would suggest that the basis for its conclusion was a belief that the possibility of reverter or right of re-entry was too remote to be of consequence for damages purposes.¹⁶⁵ Although the Minnesota rule allowing nominal damages to all owners of a possibility of reverter or right of re-entry on condemnation affords those interests a possibly desirable recognition, the portion of the rule providing for substantial damages in appropriate cases would create additional confusion and difficulty in eminent domain proceedings that the court of appeals has avoided by selecting the majority view.

E. Zoning¹⁶⁶

The North Carolina Supreme Court in *George v. Town of*

164. 38 N.C. App. at 711-12, 248 S.E.2d at 912. The rule is stated in RESTATEMENT OF PROPERTY § 53, Comment b (1936):

If, viewed from the time of the commencement of an eminent domain proceeding, and not taking into account any changes in the use of the land sought to be condemned which may result as a consequence of such proceeding, the event upon which a possessory estate in fee simple defeasible is to end is an event the occurrence of which, within a reasonably short period of time, is not probable, then the damages for a taking thereof by an eminent domain proceeding are ascertained as though the estate were a possessory estate in fee simple absolute and the entire amount thereof is awarded to the owner of the estate in fee simple defeasible. Under these circumstances the future interest has no ascertainable value.

See 2 P. NICHOLS, *supra* note 136, § 5.221[1] at 71-72; 27 AM. JUR. 2d *Eminent Domain* § 251 (1966).

In dictum the supreme court stated the general rule with approval in *City of Charlotte v. Charlotte Park & Rec. Comm'n*. The claimants of the possibility of reverter in *City of Charlotte* either did not answer or else transferred their interests to the possessor of the fee interest so that there was no dispute about title to the damages. 278 N.C. at 33, 178 S.E.2d at 606.

165. 38 N.C. App. at 710, 712, 248 S.E.2d at 911-12. See also Annot., 81 A.L.R.2d 568, 571 (1962).

166. In *Capps v. City of Raleigh*, 35 N.C. App. 290, 241 S.E.2d 527 (1978), the court of appeals held that in an action by residents to challenge a zoning ordinance brought five years and nine months after adoption of the ordinance and after defendants had spent large sums for development of the area, defendants could assert a laches defense although plaintiffs had only constructive and not actual notice of the public hearing on the zoning change.

The court of appeals in *City of Winston-Salem v. Hoots Concrete Co.*, 37 N.C. App. 186, 245 S.E.2d 536, *cert. denied*, 295 N.C. 645, 248 S.E.2d 249 (1978), held that if, in a suit by the city to enjoin defendant's operation of a concrete mixing business in a certain zone, a city zoning officer, pursuant to the authority of the city code, had approved defendant's business as a permitted use in that zone, the city could not raise the established defense that a municipality cannot be estopped

*Edenton*¹⁶⁷ decided a zoning issue of first impression concerning a provision in a city zoning ordinance prohibiting reconsideration within a six-month period of an application for rezoning of a tract. The court held that the action of the Town Council of Edenton in permitting a zoning change that it had previously refused during the preceding six months was in violation of the town zoning ordinance and therefore void.¹⁶⁸

The controlling provision of the Edenton zoning ordinance, section 14-8, stated:

When the Town Board shall have denied any application for the change of any zoning district, it shall not thereafter accept any other application for the same change of zoning amendment affecting the same property, or any portion thereof, until the expiration of six (6) months from the date of such previous denial.¹⁶⁹

Plaintiffs brought a declaratory judgment action to challenge a rezoning decision made by the Edenton Town Council allegedly in violation of this provision.¹⁷⁰ The owners of the property applied for rezoning of the tract from residential-agricultural ("R-20") to highway-commercial ("CH") on March 14, 1975.¹⁷¹ The Town Council denied the request on May 13.¹⁷² On July 8, 1975, the Council resolved to hold a public hearing on August 12 to reconsider rezoning the tract as the owners had requested in March.¹⁷³ On its own motion the Council decided at the August 12, 1975 meeting to rezone the tract to "CH" in accordance with the owners' original application.¹⁷⁴ At the same meeting, the Town Council adopted the "New Ordinance," a revised zoning ordinance for the town.¹⁷⁵ The New Ordinance contained the same section 14-8 governing successive applications for rezoning that had appeared in the "Old Ordinance."¹⁷⁶ Defendants argued that the rezoning change was made "as part of the adoption of" the New Ordinance so

to enforce its own zoning laws because the officer was acting with proper authority and not in violation of the ordinance.

167. 294 N.C. 679, 242 S.E.2d 877 (1978).

168. *Id.* at 687, 242 S.E.2d at 882.

169. *Id.* at 683, 242 S.E.2d at 880.

170. *Id.* at 680, 242 S.E.2d at 878. Plaintiffs were residents of Chowan County and were within the town's zoning jurisdiction. *Id.*

171. *Id.* at 681, 242 S.E.2d at 878.

172. *Id.*

173. *Id.* at 682, 242 S.E.2d at 879. The owners applied to have the property rezoned to "CS" (shopping center) a different use, on June 12, 1975. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

that section 14-8 would not be applicable.¹⁷⁷ Plaintiffs claimed, however, that the change was made after the New Ordinance was adopted and that section 14-8 therefore prohibited it.¹⁷⁸ Concluding that the timing of the Council's decision to rezone as related to the adoption of the New Ordinance was irrelevant, the supreme court found that the Council had violated the time restriction of section 14-8.¹⁷⁹

The court determined that the Council's July 8 action was in effect "its own petition or application for an amendment"¹⁸⁰ and that section 14-8 extended to amendments proposed by the Town Council as well as to those proposed by property owners.¹⁸¹ Looking at similar cases from various jurisdictions, the court perceived a determination to enforce such time limitations in order to prevent "circumventions of zoning provisions" such as occurred in this case.¹⁸² The policy reason for literal compliance with limitations on reapplication clauses is to protect residents who live in the area subject to rezoning from "the burden of having to protest and defend against a series of repetitious applications."¹⁸³ Finding that section 14-8 was intended to serve this protective role, the court ruled that the Council's action did not comply with the ordinance's purpose or procedure and therefore could not stand.¹⁸⁴

The court's application of section 14-8's procedural requirements to strike down the conduct of the Edenton Town Council ensured the efficacy of the protective function of the ordinance. If the court had held that the council's decision to rezone was not subject to section 14-8, it would have rendered the ordinance open to easy circumvention. The court's strict reading of the provision, therefore, affirmed the significance of such restrictions in zoning ordinances in safeguarding the interests of property owners.

177. *Id.*

178. *Id.*

179. *Id.* at 683, 242 S.E.2d at 879.

180. *Id.* at 684, 242 S.E.2d at 880. Section 14-1 of the ordinance provided that "the Town Council, the Planning Board, any department or agency of the Town, or the owner or renter of any property within the zoning jurisdiction of the Town of Edenton" could petition for a zoning amendment. *Id.* at 683, 242 S.E.2d at 880.

181. *Id.* at 685, 242 S.E.2d at 881.

182. *Id.* See *Newman v. Smith*, 217 Ga. 465, 123 S.E.2d 305 (1961) (finding that board's action in granting requested rezoning was void when second application by owner was made within 12 months of denial of first); *Tyrie v. Baltimore County*, 215 Md. 135, 137 A.2d 156 (1957) (finding that grant of special exception was void when reclassification of same property had been denied within the 18-month period established by ordinance); Annot., 52 A.L.R.3d 494, 509 (1973).

183. *Stephens v. Montgomery County Council*, 248 Md. 256, 258, 235 A.2d 701, 702 (1967), quoted with approval in *George v. Town of Edenton*, 294 N.C. at 686, 242 S.E.2d at 882 (1978).

184. 294 N.C. at 686-87, 242 S.E.2d at 882.

F. Landlord-Tenant

In *Dixon v. Rivers*,¹⁸⁵ the North Carolina Court of Appeals for the first time confronted the question of the validity of covenants for perpetual renewal in leases. In upholding the covenant at issue, the court adopted the general rule that such covenants "will be enforced where the language of the lease unmistakably indicates that the parties intended to provide for such renewal."¹⁸⁶

Plaintiffs bought a tract of land that included a portion leased to defendants by plaintiffs' predecessor in title.¹⁸⁷ The lease provided for an initial ten year period and stated that

if said property has been kept in a good state of repair, and if said parties of the second part so desire, this lease shall be renewed for an additional period of 10 years, and thereafter shall be renewable every 10 years for so long as the parties of the second part so desire.¹⁸⁸

The lease was to be binding on the parties, "their heirs, executors, administrators, and assigns."¹⁸⁹ The court rejected plaintiffs' contention that because of the language "if said parties of the second part so desire," the instrument created only a tenancy at will with an indefinite term.¹⁹⁰ Instead, the court found that a true lease was intended because of the definite ten year term with successive renewal terms of ten years.¹⁹¹ In support of its conclusion concerning the validity of the covenant of perpetual renewal, the court determined that the intention of the lessor to grant the right was clearly stated under the general rule;¹⁹² however, the question of the lessor's intent is but one factor, as the court recognized. Another significant factor is the Rule against Perpetuities. The law considers the covenant to renew a vested interest, and therefore it is not in violation of the Rule; the court accepted this standard interpretation.¹⁹³

The court's decision to test the validity of covenants of perpetual

185. 37 N.C. App. 168, 245 S.E.2d 572, *cert. granted*, 295 N.C. 733, 248 S.E.2d 867 (1978) (No. 92 PC).

186. *Id.* at 171, 245 S.E.2d at 574. *See also* Annot., 31 A.L.R.2d 607, 623 (1953).

187. 37 N.C. App. at 169, 245 S.E.2d at 573.

188. *Id.* at 170, 245 S.E.2d at 573-74.

189. *Id.*

190. *Id.* at 170-71, 245 S.E.2d at 574. The principal differentiating characteristic between a lease and a tenancy at will is the existence in a lease of a designated, fixed term. *See* Barbee v. Lamb, 225 N.C. 211, 34 S.E.2d 65 (1945); J. CRIBBET, *supra* note 41, at 53, 55; C. MOYNIHAN, *INTRODUCTION TO THE LAW OF REAL PROPERTY* 65, 83 (1962); 8 STRONG'S NORTH CAROLINA INDEX 3D *Landlord and Tenant* § 15 (1977); J. WEBSTER, *supra* note 4, §§ 89, 208.

191. 37 N.C. App. at 171, 245 S.E.2d at 574.

192. *Id.*

193. *Id.*; *cf.* J. GRAY, *THE RULE AGAINST PERPETUITIES* § 230, at 231 (4th ed. 1942) (covenant

renewal according to the intent of the parties is a reasonable one. Because there is no technical perpetuities objection to such covenants, they should be afforded legal recognition when this recognition accords with the express wishes of the lessor and lessee. In addition, covenants of perpetual renewal serve as a significant tool in the commercial realm "to aid alienability."¹⁹⁴

The court of appeals in *Jones v. Andy Griffith Products, Inc.*¹⁹⁵ for the first time considered possible standards for determining whether a lessor has reasonably or unreasonably withheld consent to a proposed sublease by the lessee. Plaintiffs leased premises in front of a shopping center (owned by plaintiff Jones) to defendant Andy Griffith Products, Inc.; Griffith in turn assigned the leasehold to defendant Silver's Enterprises, Inc.¹⁹⁶ Both Griffith and Silver's operated restaurants on the premises.¹⁹⁷ Plaintiffs sued to recover unpaid rent and taxes on the property, and defendant Silver's claimed that plaintiffs had unreasonably refused to approve a sublease to the operator of an electronics store.¹⁹⁸ The court of appeals affirmed the lower court's holding that plaintiffs' refusal to consent was reasonable and that defendants therefore were liable for the rent and taxes due.¹⁹⁹

The lease provision in issue stated: "Any subletting by Lessee shall be subject to the approval of Lessor, which approval shall not be unreasonably withheld."²⁰⁰ Plaintiffs objected to the proposed sublease on two grounds: they wished to keep a restaurant on the premises, and the suggested subtenant was already a tenant in another building in the shopping center.²⁰¹ The court looked to New Jersey and New York opinions for guidance in determining whether these stated reasons for withholding consent were reasonable. The New Jersey case, *Broad & Branford Place Corp. v. J.J. Hockenjos Co.*,²⁰² offered only a basic reasonable man standard: "the action of a reasonable man in the land-

to renew is "part of the lessee's present interest"); L. SIMES, HANDBOOK OF THE LAW OF FUTURE INTERESTS § 132, at 282 (2d ed. 1966) ("the renewed lease is but an extension of the old").

194. L. SIMES, *supra* note 193, § 230, at 282. Simes advances this view to explain why covenants of perpetual renewal are held not to violate the Rule against Perpetuities.

195. 35 N.C. App. 170, 241 S.E.2d 140, *cert. denied*, 295 N.C. 90, 244 S.E.2d 258 (1978).

196. *Id.* at 170-71, 241 S.E.2d at 141.

197. *Id.* at 172, 241 S.E.2d at 141.

198. *Id.*

199. *Id.* at 176, 241 S.E.2d at 144.

200. *Id.* at 171, 241 S.E.2d at 141.

201. *Id.* at 172, 241 S.E.2d at 142. The evidence revealed that the building was constructed for restaurant purposes and that a restaurant in the building would afford plaintiffs a greater opportunity to realize percentage rentals. *Id.* at 174, 241 S.E.2d at 143.

202. 132 N.J.L. 229, 39 A.2d 80 (1944).

lord's position."²⁰³ *American Book Co. v. Yeshiva University Development Foundation, Inc.*,²⁰⁴ the New York case, provided more concrete aid to the court in a series of "objective" tests of reasonableness: "(1) financial responsibility, (2) the 'identity' or 'business character' of the subtenant—i.e. his suitability for the particular building, (3) the legality of the proposed use, (4) the nature of the occupancy—i.e. office, factory, clinic, or whatever."²⁰⁵ The court of appeals found that lessor's refusal was grounded on considerations such as those in tests (2) and (4), and concluded that on the facts of *Jones*, the withholding of consent from a subtenant in a different business was reasonable.²⁰⁶ A caveat to the holding was the court's statement that this type of case will always turn on its facts so that a finding that a lessor's reason for refusal of consent accords with one or more of the tests may not necessarily be conclusive proof that the landlord's grounds were reasonable.²⁰⁷

One may question the significance of the court's reference to the reasonable landlord standard and the "objective" tests of *American Book Co.* because the inquiry is essentially a factual one in each case; the standards used by the court of appeals will provide no definite answers on the issue of reasonableness. Although the tests may be viewed as simply common sense expressions of the expectations of the lessor and lessee, their articulation by the court of appeals will nevertheless serve as a useful tool for analysis of this type of sublease consent provision.

203. *Id.* at 232, 39 A.2d at 82. The court also stated:

Arbitrary considerations of personal taste, sensibility, or convenience do not constitute the criteria of the landlord's duty under an agreement such as this. Personal satisfaction is not the sole determining factor. . . . The term "reasonable" is relative and not readily definable. As here used, it connotes action according to the dictates of reason—such as is just, fair and suitable in the circumstances.

Id. See generally Annot., 54 A.L.R.3d 679 § 6 (1973).

204. 59 Misc. 2d 31, 297 N.Y.S.2d 156 (1969).

205. *Id.* at —, 297 N.Y.S.2d at 160.

206. 35 N.C. App. at 176, 241 S.E.2d at 144.

207. *Id.* The court noted that the burden of proof on the unreasonableness of the landlord's refusal to consent is on the lessee. *Id.* See generally *Broad & Branford Place Corp. v. J.J. Hockenos Co.*, 132 N.J.L. 229, 233, 39 A.2d 80, 82 (1944); Annot., 54 A.L.R.3d 679, 683 (1973).

The court did not have to consider whether the proposed subtenant's status as a current tenant of plaintiff *Jones* in the shopping center would be reasonable grounds to refuse consent to the sublease. One court has found that this excuse—that the proposed subtenant was a tenant in another building owned by the landlord—was "insufficient in law" to constitute a reasonable refusal of consent by the landlord. *Krieger v. Helmsley-Spear, Inc.*, 62 N.J. 423, 424, 302 A.2d 129, 129 (1973).

*G. Personal Property*²⁰⁸

The subject of the court of appeals' inquiry in *Montford v. Grohman*²⁰⁹ was the effect on plaintiff's constitutional personal property exemption (for the protection of personal property from the claims of creditors) of a security interest held by defendant finance company in plaintiff's household goods. Plaintiff and defendant finance company entered into a consumer loan agreement by which defendant took a security interest in all of plaintiff's personal property and plaintiff waived her legal exemption rights.²¹⁰ Plaintiff defaulted on the loan; defendant established its right to possess plaintiff's property and that her belongings were worth no more than \$500.²¹¹ The lower court found that plaintiff was entitled to her constitutional personal property exemption of \$500,²¹² despite the security interest held by the finance company.²¹³ Holding that the security interest took priority over the personal property exemption, the court of appeals reversed and determined that plaintiff was not entitled to retain \$500 of personal property.²¹⁴

The constitutional personal property exemption exempts "from sale under execution or other final process of any court, issued for the collection of any debt" an amount of personal property, not less than \$500, for all state residents.²¹⁵ Plaintiff argued that this exemption should protect her last \$500 of assets even though she had freely entered into the security agreement with defendant finance company.²¹⁶ The court of appeals, however, declared that the exemption is limited to the situation expressly covered by its language—it serves to preserve a debtor's property from final sale but not to guarantee that he will be

208. The supreme court in *Lee-Moore Oil Co. v. Cleary*, 295 N.C. 417, 245 S.E.2d 720 (1978), found that the owner of a chattel and the owner of the realty to which the chattel is attached may agree expressly or impliedly, orally or in writing, that the chattel will remain the personal property of the owner rather than become a fixture of the property, and that such an agreement will be binding on subsequent purchasers of the realty who take with knowledge of the arrangement.

209. 36 N.C. App. 733, 245 S.E.2d 219 (1978), *appeal dismissed*, 295 N.C. 551, 248 S.E.2d 727 (1978).

210. *Id.* at 734, 245 S.E.2d at 220.

211. *Id.* N.C. GEN. STAT. § 25-9-503 (Cum. Supp. 1977) establishes the right of the secured party to take possession of the collateral upon default of the debtor.

212. N.C. CONST. art. X, § 1.

213. 36 N.C. App. at 734, 245 S.E.2d at 221.

214. *Id.* at 738, 245 S.E.2d at 223.

215. N.C. CONST. art. X, § 1. N.C. GEN. STAT. § 1-378 (1969) limits the amount of the personal property exemption to a maximum of \$500.

216. 36 N.C. App. at 735, 245 S.E.2d at 221.

able to keep his last assets in all circumstances.²¹⁷ The owner is free to dispose of or encumber those assets in a manner outside the reach of the personal property exemption, that is, by voluntary sale, gift, or, as here, security interest.²¹⁸ Plaintiff's choice to enter into the security agreement was binding on her, and the personal property exemption did not render defendant finance company's security interest null.²¹⁹ The New Mexico court in *Hernandez v. S.I.C. Finance Co.*,²²⁰ cited by the court of appeals, reached a similar conclusion on the theory that if an owner can sell his otherwise "exempt" property, he certainly can encumber it with a security interest. The owner then cannot call upon the statutory exemption for protection from his contract.²²¹

Although the court reached the proper result according to the language and policy of the exemption, it did suggest that this area might be an appropriate one for legislative action.²²² If such security interests in household goods were barred, a debtor's final assets would be preserved, except for sale or gift by the debtor.²²³ Whether this result would be sound is questionable; as the New Mexico court stated, subjecting one's goods to a security interest is not as final a step as selling those goods. Therefore, if the legislature were to prevent security interests in household goods, arguably it should also prevent a debtor from selling his final assets. Neither result accords with the debtor's ownership rights in the property. The *Montford* result is preferable to a legislative change in the personal property exemption because it recognizes the owner's power to dispose of his property as he wishes through voluntary security agreements.

217. *Id.* at 736, 245 S.E.2d at 222.

218. *Id.*

219. *Id.* at 737, 245 S.E.2d at 222; *cf.* *Gaster v. Hardie*, 75 N.C. 460 (1876) (establishing the following order of payment when debtor has given a chattel mortgage: (1) mortgage debt, (2) debtor's personal property exemption, and (3) amounts owing to a judgment creditor).

The court expressly stated that the waiver provision in the agreement was not the basis of its decision. 36 N.C. App. at 737, 245 S.E.2d at 222-23. An executory waiver of the right to the exemption by the debtor is not enforceable. *See Branch & Co. v. Tomlinson*, 77 N.C. 388, 391 (1877).

220. 79 N.M. 673, 448 P.2d 474 (1968).

221. *Id.* at 675, 448 P.2d at 476. The court noted that "such property [often] is the poorman's only source of cash in an emergency," and he may need to sell or encumber it. *Id.*

222. 36 N.C. App. at 738, 245 S.E.2d at 223. The court referred to *First National Bank of Amarillo v. LaJoie*, 537 P.2d 1207 (Sup. Ct. Okla. 1975). The controlling statute in *LaJoie* prohibited a seller "in [a] consumer credit sale from taking [a] security interest in property other than [the] property sold." *Id.* at 1208, OKLA. STAT. tit. 14A, § 2-407 (1971). The provision is from the UNIFORM CONSUMER CREDIT CODE § 2.407. The limitation on security interests in § 2.407 applies, however, only to consumer credit sales and not to consumer loans (the situation in *Montford*). *Id.*; *see* 537 P.2d at 1209.

223. 36 N.C. App. at 738, 245 S.E.2d at 223.

*H. Wills, Trusts and Estates*²²⁴

The North Carolina Court of Appeals for the first time interpreted the meaning of "net income" in the determination of the surviving spouse's year's allowance under G.S. 30-31²²⁵ in *Pritchard v. First-Citizens Bank & Trust Co.*²²⁶ In *Pritchard* the widow petitioned the clerk of superior court for allotment of a year's allowance pursuant to G.S. 30-27²²⁷ (allowance assigned in superior court) rather than the minimum year's allowance of \$2000 in G.S. 30-15.²²⁸ Determining that the widow's petition complied with G.S. 30-31, the superior court awarded her a year's allowance of \$40,640; one of the remaindermen under the trust established by decedent for his wife and children appealed.²²⁹

224. In a will construction case, *Sutton v. Sutton*, 35 N.C. App. 670, 242 S.E.2d 644 (1978), the court of appeals construed a gift by a husband to his wife of "a sufficient amount of my real and personal property when added to the value of my home, and other property that she will receive outside of this Will, that will equal one-third of my net estate" to be a gift of an undivided interest in the testator's real property rather than a specific dollar figure because testator provided in the will that the property was to be managed and the income to be distributed for the benefit of his wife.

In *Thompson v. Ward*, 36 N.C. App. 593, 244 S.E.2d 485, *cert. denied*, 295 N.C. 556, 248 S.E.2d 735 (1978), the court of appeals held that a holographic devise of "the use of" certain realty to the heirs of testatrix's brother-in-law for "as long as they wish to live there" was a gift of only a life estate despite the statutory presumption that any devise of realty is in fee simple under N.C. GEN. STAT. § 31-38 (1977); the testatrix's intent to convey a lesser estate was clearly shown because she used language of "fee simple" elsewhere when she so intended.

In *In re Will of Weston*, 38 N.C. App. 564, 248 S.E.2d 359 (1978), the court of appeals found that an attesting witness, if he had sight at the time of the execution of the will and was able to testify satisfactorily that the will read to him was the one he had witnessed, was "available" to give testimony to prove an attested will under N.C. GEN. STAT. § 31-18.1 (1976) even though he was blind at the time of the proceeding.

In a caveat proceeding challenging testatrix's capacity to make a will in *In re Will of Worrell*, 35 N.C. App. 278, 241 S.E.2d 343, *cert. denied*, 295 N.C. 90, 244 S.E.2d 263 (1978), the court of appeals held that an instruction by the trial court that the jury was to consider whether testatrix "recognized her obligation to the objects of her bounty and their relation to her" was not in error and that this factor was relevant to the question of testamentary capacity.

225. N.C. GEN. STAT. § 30-31 (1976) provides in part:

The said commissioners shall be sworn by the magistrate and shall proceed as prescribed in this Chapter, except that they may assign to the plaintiff a value sufficient for the support of the plaintiff according to the estate and condition of the decedent and without regard to the limitations set forth in this Chapter . . . and the total value of all allowances shall not in any case exceed the one half to the average annual net income of the deceased for three years next preceding his death.

The purpose of the year's allowance is to provide the surviving spouse with immediate funds for support pending administration of the decedent's estate.

226. 38 N.C. App. 489, 248 S.E.2d 467 (1978).

227. N.C. GEN. STAT. § 30-27 (1976). For discussion of the operation of the allowance assigned in superior court, see 1 N. WIGGINS, WILLS AND ADMINISTRATION OF ESTATES IN NORTH CAROLINA § 173 (1964).

228. N.C. GEN. STAT. § 30-15 (1976).

229. 38 N.C. App. at 490-91, 248 S.E.2d at 468-69. The evidence established that the commissioners had based the award on the decedent's "adjusted gross income" from his federal income

Holding that "net income" under G.S. 30-31 signifies the after-tax income of the decedent, the court of appeals reversed the award because the lower court had improperly used an adjusted gross income base.²³⁰

Appellant contended that the allowance to the surviving spouse of a maximum amount of "one half of the average annual net income of the deceased for three years next preceding his death" should be construed as one-half of the average sum left after the deduction of federal and state income taxes and not one-half of the average adjusted gross income of decedent.²³¹ The court of appeals looked to the purpose of the statute in order to resolve the issue. The 1868-69 Legislative Session enacted the alternative system that now exists: the widow may take either a minimal allowance,²³² or, upon the required showing,²³³ may take an amount "sufficient for the support of herself and her family according to the estate and condition of her husband" ²³⁴ The court found that the intention of the second alternative, by which the spouse may take a much greater sum than the \$2000 of G.S. 30-15, was to grant the surviving spouse "of a solvent decedent . . . an amount sufficient to maintain for a period that standard of living to which he or she had been accustomed" ²³⁵ The court concluded that the allowance should be based upon that amount of income that the family in the past actually had had available for its living needs.²³⁶ "Net income" thus under G.S. 30-31 can refer only to the decedent's income after deductions for federal and state income taxes are made.²³⁷

The decision of the court of appeals is a sound one. G.S. 30-27 provides the surviving spouse with the opportunity to claim an allowance based upon the familial standard of living prior to decedent's death. This privilege should not be abused by allowing the spouse to claim an allowance based on one-half of the average gross income of

tax returns for the three years before his death. The average adjusted gross income figure based on the three years was \$81,289. *Id.* at 490, 248 S.E.2d at 469.

230. *Id.* at 493-94, 248 S.E.2d at 470-71.

231. *Id.* at 490, 248 S.E.2d at 469.

232. Law of March 27, 1869, ch. 93, § 10, 1868-69 N.C. Pub. Laws 205 (current version at N.C. GEN. STAT. § 30-15 (1976)).

233. *Id.* § 22, 1868-69 N.C. Pub. Laws 205 (current version at N.C. GEN. STAT. § 30-29 (1976)).

234. *Id.* § 24, 1868-69 N.C. Pub. Laws 205 (current version at N.C. GEN. STAT. § 30-31 (1976)).

235. 38 N.C. App. at 491, 248 S.E.2d at 469. The court emphasized that the § 30-31 computation provides the maximum allowance that may be assigned; the award may of course be for less than this maximum amount. *Id.* at 493, 248 S.E.2d at 470.

236. *Id.* at 493, 248 S.E.2d at 470.

237. *Id.*

the decedent without taking into account the tax burdens incurred by that income. The court's interpretation—limiting the basis for the allowance to the after-tax income of the decedent—protects the interests of both the surviving spouse and the estate and is consonant with the policy of the alternative allowance procedures.

In *Dew v. Shockley*,²³⁸ the court of appeals determined that testatrix's gift of all of her property to her "two brothers and three sisters, to have and to hold the same for and during the term of their natural lives with remainder in fee to their children, in equal shares, the children of any deceased child to take the share the parent, if living, would take,"²³⁹ conveyed a joint life estate with right of survivorship to her brothers and sisters and a remainder in fee to their children *per capita*. Although the court's construction of the gift as a joint life estate is correct according to North Carolina precedent, its reasoning concerning the *per capita* remainder to the children is erroneous.

The common law presumption favoring joint tenancies with right of survivorship still applies to the creation of life estates;²⁴⁰ G.S. 41-2,²⁴¹ which abolishes survivorship in joint tenancies in estates of inheritance, is not applicable. Because there was no language in the will indicating an intent that the brothers and sisters take as tenants in common, the court found the presumption controlling.²⁴² Similarly, the general rule in class gifts is that members of the class take *per capita* rather than *per stirpes*.²⁴³ The testatrix's intent was clear on this point because she gave the remainder to the children "in equal shares."²⁴⁴ The court concluded that any children of a deceased child would take *per stirpes*, however, because any gift to them was expressly limited to the amount that the parent would have taken if alive.²⁴⁵

The court stated that any children alive at the testatrix's death would take a vested remainder subject to open to allow children born after her death but before the termination of the life estate to share in

238. 36 N.C. App. 87, 243 S.E.2d 177, *cert. denied*, 295 N.C. 465, 246 S.E.2d 9 (1978).

239. *Id.* at 88, 243 S.E.2d at 179.

240. *Id.* at 89, 243 S.E.2d at 179; *see* *Burton v. Cahill*, 192 N.C. 505, 135 S.E. 332 (1926) (deed of life estate to two daughters with remainder to their children: daughters took as joint tenants with right of survivorship and children took *per capita*).

241. N.C. GEN. STAT. § 41-2 (1976).

242. 36 N.C. App. at 89-90, 243 S.E.2d at 180.

243. *See* *Wachovia Bank & Trust Co. v. Bryant*, 258 N.C. 482, 128 S.E.2d 758 (1963); *Burton v. Cahill*, 192 N.C. 505, 135 S.E. 332 (1926).

244. 36 N.C. App. at 90, 243 S.E.2d at 180.

245. *Id.*

the gift.²⁴⁶ The court, however, confused this question of when the class closes with the question of the minimum membership of the class:

Were the distribution purely *per capita*, with the roll called at the falling in of the life estate, children of brothers and sisters, alive at testatrix's death, or born during the life estate, but dead by the falling in of the life estate, would not be in the class of takers, and their children would take nothing. The *per stirpes* direction preserves the grandchildren's share.²⁴⁷

Because the children took a vested remainder, the *per stirpes* direction was not necessary to preserve their interests or make them transmissible.²⁴⁸ If a child were to die prior to the termination of the life estate, his remainder would not be defeated, absent an express or implied condition of survivorship; the authoritative view, which the court apparently did not follow, is that there is no implied condition of survivorship in a gift to a class such as this.²⁴⁹

The limitation to "the children of any deceased child" meant that the children of the brothers and sisters took a vested remainder subject to divestiture if they died before the life tenants and left children; the children's children then would take their interests.²⁵⁰ The critical case arises, however, if a child were to predecease the life tenants and leave no children. According to the court, his interest would be lost. This approach is contrary to the general view that the child's remainder will pass to his estate because it has not been divested by the occurrence of a condition subsequent.²⁵¹ Therefore, the court's implication that a child must survive to the termination of the life estate in order to take an interest in the property is inconsistent both with the general rules on minimum membership for class gifts and with prior North Carolina law.²⁵²

246. *Id.* at 91, 243 S.E.2d at 181. See also *Wachovia Bank & Trust Co. v. Taylor*, 255 N.C. 122, 120 S.E.2d 588 (1961); *Beam v. Gilkey*, 225 N.C. 520, 35 S.E.2d 641 (1945) (direction that property be equally divided among children of life tenant did not affect vesting of remainder); *Chas. W. Priddy & Co. v. Sanderford*, 221 N.C. 422, 20 S.E.2d 341 (1942).

247. 36 N.C. App. at 90, 243 S.E.2d at 180.

248. 2 L. SIMES & A. SMITH, *THE LAW OF FUTURE INTERESTS* § 653, at 105 (2d ed. 1956).

249. *Id.* § 578, at 19. The supreme court has found an implied condition of survivorship in an alternative contingent remainder to a class of brothers and sisters, although the condition precedent was unrelated to survivorship. *Lawson v. Lawson*, 267 N.C. 643, 148 S.E.2d 546 (1966).

250. 2 L. SIMES & A. SMITH, *supra* note 248, § 583, at 25-26; see *Parker v. Parker*, 252 N.C. 399, 113 S.E.2d 899 (1960).

251. 2 L. SIMES & A. SMITH, *supra* note 248, § 583, at 26-27.

252. See *Pinnell v. Downton*, 224 N.C. 493, 31 S.E.2d 467 (1944) (gift to two named children rather than to class); *Mason v. White*, 53 N.C. (8 Jones) 421 (1862). The supreme court in *Mason* held that in a gift of a life estate to testator's wife and remainder to the wife's children, the estate of a child who had predeceased the wife (life tenant) could claim the child's share: "there is no ground on which it can be concluded that the death of one of the legatees divested her legacy in

Although the court's interpretation causes no difficulty at the present time because no children of the brothers and sisters have predeceased the life tenants without children, this problem could certainly arise in the future. Because the textatrix created a vested remainder in the children without any express condition of survival, the court's construction would ignore her intention by depriving the estate of children who predecease the life tenants and leave no children of their own from sharing in the property.

KATHRINE AYCOCK McLENDON
S. LEIGH RODENBOUGH

X. TAXATION

A. State and Local Sales Tax

In *Gregory Poole Equipment Co. v. Coble*,¹ the North Carolina Court of Appeals held that exemption from the state sales tax does not preclude the assessment of a local sales tax.²

Plaintiff, a dealer in industrial equipment, had accepted used machinery as a trade-in on new machinery. Although the three percent state sales tax was paid on the sale of the new equipment, no local sales tax was paid to three counties in which the dealer operated because the equipment was sold and delivered to purchasers outside those counties.³ Later plaintiff sold the used equipment to purchasers within those same three counties, but paid neither state nor local sales tax on the sales.⁴ Because state sales tax had been paid on the sale of the new

favor of the surviving legatees. To have this effect, there must be words of exclusion; e.g., "to the children of A, living at the time of her death." *Id.* at 423.

1. 38 N.C. App. 483, 248 S.E.2d 378 (1978).

2. *Id.* at 487, 248 S.E.2d at 381.

3. *Id.* at 484, 248 S.E.2d at 379. N.C. GEN. STAT. § 105-467 (1972) provides:

The local sales tax . . . shall be applicable to such retail sales . . . which are made . . . by retailers whose place of business is located within the taxing county. . . . However, no tax shall be imposed where the tangible personal property sold is delivered to the purchaser at a point outside the taxing county by the retailer or his agent, or by a common carrier.

4. 38 N.C. App. at 484, 248 S.E.2d at 379.

equipment, the used equipment sales were clearly exempt from state sales tax under G.S. 105-164.13(16).⁵

Plaintiff's contention that the used equipment sale was also exempt from local sales tax was based on the language of the statute governing local sales tax, which authorizes a one percent local sales tax on sales of articles "now subject to" the three percent state sales tax.⁶ Plaintiff argued that a sale is "subject to" state sales tax only when that tax is assessed and collected.⁷ Using this interpretation, plaintiff maintained that because its sale of the used equipment was not "subject to" the state tax by reason of the exemption, local sales tax could not apply.⁸

The court agreed with the Secretary of Revenue that "subject to" refers not to those transactions for which a state sales tax is actually assessed, but to any transaction to which the state sales tax is applicable, without regard to whether that transaction might ultimately qualify for an exemption under another section of the statute.⁹ Because plaintiff's sale of the used equipment was "subject to" the state sales tax before that sale qualified for the exemption, local sales tax could be collected on the sale, even though state sales tax was not.¹⁰

The court noted that, for local sales tax not to apply to the transaction, plaintiff would have had to have qualified for an exemption from that tax, just as it had for the state sales tax.¹¹ This conclusion was supported by the language of G.S. 105-467,¹² which clearly states that the exemptions and exclusions applicable to the state sales tax are equally applicable to the local tax. Plaintiff had qualified for an exemption from the state tax on the sale of the used equipment because it had paid tax on the new equipment for which the used was taken in trade.¹³ Had plaintiff also paid local sales tax on the sale of the new equipment, it would have owed no local tax on the later sale of the used equipment.

5. N.C. GEN. STAT. § 105-164.13(16) (1972) provides that sales of used articles taken in trade are exempt from state sales tax "provided the tax levied in this Article is paid on the gross sales price of the new article."

6. *See id.* § 105-467.

7. 38 N.C. App. at 487, 248 S.E.2d at 380.

8. *Id.*

9. *Id.* at 487, 248 S.E.2d at 381.

10. *Id.*

11. *Id.*

12. N.C. GEN. STAT. § 105-467 (1972). "The exemptions and exclusions contained in G.S. 105-164.13 . . . shall apply with equal force and in like manner to the local sales and use tax authorized to be levied and imposed under this Article." *Id.*; *see note 5 supra.*

13. *See note 5 and accompanying text supra.*

This result is undoubtedly correct if the local and state sales tax provisions are to be harmonized. In G.S. 105-474¹⁴ the legislature has clearly expressed its intent that all provisions relevant to the state sales tax apply to the local sales tax, and that the provisions governing each are to be harmonized.¹⁵ If the state sales tax exemptions and exclusions are to apply "with equal force and in like manner"¹⁶ to the local tax, whether a local exemption is available must be determined by reference to the statute governing state sales tax exemptions.¹⁷ The particular exemption involved in this case deals with transactions in used goods. Those goods are exempt from state sales tax only when they are taken in trade on a new article, on which the state sales tax is paid.¹⁸ A condition must be met for the exemption to apply. If the exemption is to apply "with equal force" to the local sales tax, an equivalent condition must be met. Because the transaction in this case clearly did not meet this condition, the local sales tax was properly assessed.

B. Estate and Inheritance Taxes

The North Carolina Court of Appeals, in *First National Bank of Shelby v. Dixon*,¹⁹ held that the beneficiary of a life insurance policy must contribute to payment of federal estate and state inheritance taxes incurred by reason of inclusion of the policy's proceeds in a decedent's gross estate.²⁰ The court also held that the federal and state tax liabilities caused by the policy's inclusion are not debts of the estate but liens upon the asset in the hands of the beneficiary.²¹

Because federal and state law apparently conflicted on the issue of liability for estate taxes attributable to inclusion of life insurance policies in the estate, and the North Carolina statute was silent on the issue of liability for inheritance taxes on the same amount, plaintiff bank, as administrator of an estate, had brought an action for declaratory judgment against the beneficiary of two life insurance policies.²² The federal Internal Revenue Code gives the personal representative of an

14. N.C. GEN. STAT. § 105-474 (1972).

15. *See id.*

16. *Id.* § 105-467.

17. *Id.* § 105-164.13 (1972 & Cum. Supp. 1977) is aimed primarily at exempting sales of certain products from the state sales tax. Prescription drugs are, for example, exempt from the state sales tax and therefore also exempt from local sales tax. *See id.* § 105-164.13(13) (1972).

18. *Id.* § 105-164.13(16) (1972).

19. 38 N.C. App. 430, 248 S.E.2d 416 (1978).

20. *Id.* at 435-36, 248 S.E.2d at 419-20.

21. *Id.* at 437, 248 S.E.2d at 420.

22. *Id.* at 431, 248 S.E.2d at 417.

estate the right to recover from beneficiaries of life insurance policies the proportionate share of tax imposed on the estate when the proceeds of the policy were included in the decedent's gross estate,²³ unless decedent's will directs otherwise.²⁴ North Carolina case law has held, however, that unless a decedent's will contains contrary instructions, federal estate taxes are to be paid by the residuary estate without contribution even though the estate includes nonprobate assets such as life insurance.²⁵ Further, the state statute, G.S. 105-13,²⁶ provides that proceeds of life insurance policies receivable by beneficiaries are taxable when the decedent retained incidents of ownership,²⁷ but does not specify who shall pay the state tax.

Defendant, decedent's wife, was the residuary legatee of decedent's estate and the beneficiary of two life insurance policies owned by decedent and valued at \$160,000.²⁸ The proceeds of the policies²⁹ had been included in decedent's gross estate for purposes of federal³⁰ and North Carolina³¹ taxation, and therefore gave rise to both estate and

23. Under the federal statute, I.R.C. § 2042, "incidents of ownership," which would cause the policy to be included in the decedent's gross estate, include the "power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan," etc. Treas. Reg. § 20.2042-1(c)(2) (1958). The term

also includes a reversionary interest in the policy or its proceeds, whether arising by the express terms of the policy or other instrument or by operation of law, but only if the value of the reversionary interest immediately before the death of the decedent exceeded five percent of the value of the policy.

Id. § 20.2042-1(c)(3).

Under North Carolina law, the term "incident of ownership" includes a reversionary interest in the policy or its proceeds. A reversionary interest "includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him." N.C. GEN. STAT. § 105-13(2) (1972).

24. I.R.C. § 2206 provides:

Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the taxable estate.

25. See *Cornwell v. Huffman*, 258 N.C. 363, 128 S.E.2d 798 (1972); *Craig v. Craig*, 232 N.C. 729, 62 S.E.2d 336 (1950). See generally Comment, *Apportionment of the Federal Estate Tax—Should North Carolina Adopt an Apportionment Statute?*, 52 N.C.L. REV. 737 (1974).

26. N.C. GEN. STAT. § 105-13 (1972).

27. See note 23 *supra*.

28. 38 N.C. App. at 431, 248 S.E.2d at 417.

29. The proceeds of the policies, after adjustments for the applicable marital deduction and other exemptions, were included in the decedent's gross estate. *Id.*; see I.R.C. § 2206. When proceeds of the policy are received by the surviving spouse and a marital deduction is allowed (I.R.C. § 2056), § 2206 only applies to such insurance policy proceeds to the extent that those proceeds exceed the aggregate marital deduction.

30. See I.R.C. § 2042.

31. See N.C. GEN. STAT. § 105-13 (1972).

inheritance taxes. Decedent's will did not indicate how the tax liability was to be satisfied, and the personalty in the estate was insufficient to pay the taxes assessed by reason of the policies' inclusion in the gross estate.³² Plaintiff argued that decedent's wife, as beneficiary of the policies, should pay the ratable portion of the estate and inheritance taxes assessed because of the inclusion.³³

Defendant contended that she was not responsible for any portion of the federal estate taxes because those taxes were a debt of the estate, and therefore had to be satisfied out of the residuary estate.³⁴ This contention rested on *Park v. Carroll*,³⁵ in which federal estate taxes were clearly denominated debts of the estate chargeable to the residuary estate and not against specific legacies or devises.³⁶ The court distinguished *Park*, stating that the contention that federal estate taxes are debts of the estate is premised on the estate's personal representative controlling "all of the assets of the estate to which [he] may look for satisfaction of the tax imposed and for which he is primarily liable."³⁷ Because the personal representative does not have control of nonprobate assets such as life insurance proceeds, the court said the tax liability incurred on those proceeds is not a debt of the estate, but a lien upon the assets in the hands of the beneficiaries.³⁸ The court thus carved out an exception to the *Park* rule that required the federal estate tax liability, as a debt of the estate, to be satisfied out of the residuary estate.³⁹ The exception is narrow: to the extent that the federal estate tax liability is based on inclusion in the gross estate of nonprobate assets such as life insurance,⁴⁰ the tax liability is not a debt satisfiable out of the residuary estate, but a lien on the asset in the hands of the recipi-

32. 38 N.C. App. at 431-32, 248 S.E.2d at 417.

33. *Id.* at 432, 248 S.E.2d at 418.

34. *Id.* at 437, 248 S.E.2d at 420.

35. 18 N.C. App. 53, 196 S.E.2d 40 (1973).

36. The *Park* court noted:

In North Carolina where the testator fails to express in his will any direction as to the payment of the debts of the estate (including federal estate taxes), legacies abate in the following order: (1) residuary, (2) general, (3) specific and demonstrative, ratably and, after the personalty has been exhausted, the same order applies to the testator's realty.

Id. at 57, 196 S.E.2d at 43. See also N.C. GEN. STAT. § 28A-15-5 (1976).

37. 38 N.C. App. at 437, 248 S.E.2d at 420.

38. *Id.*

39. "[I]n the absence of a contrary testamentary provision, federal estate taxes are chargeable to the residuary estate" 18 N.C. App. at 58, 196 S.E.2d at 43.

40. The exception applies not only to life insurance proceeds under I.R.C. § 2206, but also to property over which decedent had a power of appointment, as governed by I.R.C. § 2207. See *First Nat'l Bank v. Wells*, 267 N.C. 276, 148 S.E.2d 119 (1966).

ent or beneficiary.⁴¹ The estate's personal representative can, therefore, reach those nonprobate assets for satisfaction of any tax their inclusion in the gross estate might incur.

This decision brings North Carolina law squarely in line with the federal statute.⁴² Although the court was compelled to distinguish *Park* in order to find that the federal estate tax provision did not conflict with North Carolina principles governing payment of estate taxes from the residuary estate,⁴³ had any conflict existed the federal statute would have controlled.⁴⁴

The court had less difficulty resolving the question whether a beneficiary of life insurance policies should contribute to state inheritance taxes, even though no North Carolina statute or decision deals precisely with the issue. The North Carolina statute provides that proceeds of life insurance policies receivable by beneficiaries are subject to inheritance tax when the decedent retained incidents of ownership, but does not specify who shall pay the tax.⁴⁵ G.S. 105-15 does provide that devisees under decedent's will are primarily liable for inheritance taxes on property devised to them under the will, but does not address the question of liability for inheritance taxes on nonprobate assets such as life insurance policies.⁴⁶ Confronted with statutory silence on the issue, the court was "constrained by equity and the example of our federal and sister state governments"⁴⁷ to hold that the beneficiary is primarily liable for taxes incurred by reason of a life insurance policy's inclusion in decedent's taxable estate.⁴⁸

This decision ensures that the personal representative of the estate, who is liable under state law for all inheritance taxes due on any estate under his control,⁴⁹ may proceed against the beneficiary of a life insurance policy when the proceeds are includable in the decedent's taxable estate under G.S. 105-13.⁵⁰ Otherwise, inheritance taxes imposed by reason of both probate and nonprobate assets would have to be satisfied by the estate without contribution from the nonprobate assets, cre-

41. 38 N.C. App. at 437, 248 S.E.2d at 420.

42. By judicial decision, North Carolina law now parallels both I.R.C. § 2206 and I.R.C. § 2207. See note 40 *supra*.

43. 38 N.C. App. at 434, 248 S.E.2d at 419.

44. *Id.*

45. N.C. GEN. STAT. § 105-13 (1972).

46. *Id.* § 105-15.

47. 38 N.C. App. at 436, 248 S.E.2d at 420.

48. *Id.*

49. N.C. GEN. STAT. § 105-28 (1972).

50. *Id.* § 105-13.

ating an undue burden on the probate assets of the estate.⁵¹

C. Ad Valorem Taxes :⁵² Exempt Property⁵³

All real and personal property within North Carolina is subject to taxation⁵⁴ unless excluded from the tax base⁵⁵ or exempt from taxation.⁵⁶ The statutory exemptions and exclusions are based not only on the character of the owner, but also on how the property is used.⁵⁷ If the use of the property can be characterized as commercial, that property will have to bear its just share of the community tax burden, regardless of the character of the owner.⁵⁸ As might be expected, statutes exempting specific property from taxation because of the purpose for which that property is used are construed strictly against exemption and in favor of taxation.⁵⁹

In *In re North Carolina Forestry Foundation*,⁶⁰ the North Carolina Supreme Court affirmed two court of appeals decisions⁶¹ denying an

51. It should be kept in mind that estate planning can avoid the result dictated by this case. The life insurance policy will not be swept back into decedent's gross estate unless decedent retained incidents of ownership in the policy. See note 23 *supra*. Also, decedent's will can specify how the federal estate and state inheritance taxes are to be satisfied. See text accompanying note 24 *supra*.

52. Uniform appraisal standards for all real and personal property subject to ad valorem taxation appear in N.C. GEN. STAT. § 105-283 (Interim Supp. 1978). In 1978 the legislature amended the statute to provide that the value of land acquired by eminent domain is not evidence of the true value in money of comparable land for purposes of appraising property for ad valorem taxation. Law of June 16, 1978, ch. 1297, § 1, 1977 N.C. Sess. Laws, 2d Sess. 1978, at 215. The amendment is effective for tax years beginning on or after January 1, 1979.

The amendment serves to ensure that land will be appraised at its "true value," since the higher prices sometimes paid for strategically located land acquired by eminent domain will not be allowed to distort the appraised value of similar property.

53. The second session of the 1977 legislature amended § 105-275(1) to extend from 12 months to 48 months the period that property awaiting export may be stored without losing its exemption from county property taxes. The amendment is effective January 1, 1980. Law of June 16, 1978, ch. 1200, § 4, 1977 N.C. Sess. Laws, 2d Sess. 1978, at 121 (to be codified at N.C. GEN. STAT. § 105-275(1)).

54. See N.C. GEN. STAT. § 105-274 (1972).

55. See *id.* § 105-275 (Cum. Supp. 1977). Under the statute certain classes of both real and personal property are designated special classes and are not to be "listed, appraised, assessed, or taxed." *Id.*

56. See *id.* § 105-278.1 to .9.

57. See, e.g., *id.* § 105-278.4. This statute exempts real and personal property owned by a nonprofit educational institution if that property is of a kind "commonly employed in the performance of those activities . . . properly incident to the operation of an educational institution" and if the property is "wholly and exclusively used for educational purposes." *Id.*

58. See *Trustees of Guilford College v. Guilford County*, 219 N.C. 347, 13 S.E.2d 622 (1941); *County of Rockingham v. Board of Trustees of Elon College*, 219 N.C. 342, 13 S.E.2d 618 (1941).

59. See *Latta v. Jenkins*, 200 N.C. 255, 258, 156 S.E. 857, 858-59 (1931).

60. 296 N.C. 330, 250 S.E.2d 236 (1979).

61. 35 N.C. App. 414, 242 S.E.2d 492 (1978), *aff'd*, 296 N.C. 330, 250 S.E.2d 236 (1979) (tax liability for Foundation's property in Onslow County (approximately 51,000 acres)); 35 N.C. App.

exemption or exclusion for 81,000 acres of timberland owned by the North Carolina Forestry Foundation. The Foundation claimed tax exempt status for the timberland under four statutes. Three of those statutes exempt property used exclusively for educational, scientific or charitable purposes;⁶² the other exempts property owned by the University of North Carolina.⁶³

The court found that the Foundation's property was exempt under none of the statutes. In 1945, the Foundation had leased the forest to a paper company for ninety-nine years in order to secure an outlet for the forest's merchantable timber and pulpwood.⁶⁴ Under the original lease, the Foundation was responsible for cutting and delivering the timber and pulpwood to the paper company, and retained operational control of the forest.⁶⁵ That control was relinquished pursuant to a 1951 lease amendment, which gave the lessee virtually complete control over the forest.⁶⁶ Although all revenues received from the lease were still used by the Foundation for educational purposes, the land itself was operated by the corporate lessee primarily as a commercial timber farm and only incidentally used by the Foundation for research.⁶⁷ The property could not qualify for tax exemption, therefore, under any of the three statutes requiring *exclusive* use for educational, scientific or charitable purposes.⁶⁸ Nor could it qualify for exemption as property

430, 242 S.E.2d 502 (1978), *aff'd*, 296 N.C. 330, 250 S.E.2d 236 (1979) (tax liability for approximately 30,000 acres in Jones County).

62. N.C. GEN. STAT. § 105-275(12) (Cum. Supp. 1977) excludes from the tax base "[r]eal property owned by a nonprofit corporation or association exclusively held and used by its owner for educational and scientific purposes as a protected natural area." *Id.* § 105-278.4 exempts real and personal property used for educational purposes if "[w]holly and exclusively used for educational purposes by the owner or occupied gratuitously by another nonprofit educational institution . . . and wholly and exclusively used by the occupant for nonprofit educational purposes." *Id.* § 105-278.6(7) exempts property owned by "[a] nonprofit, life-saving, first aid, or rescue squad organization" if "[a]s to real property, it is actually and exclusively occupied and used . . . for charitable purposes."

63. *Id.* § 116-16 (1972) exempts the lands and other property belonging to the University of North Carolina from all kinds of public taxation.

64. 296 N.C. at 332, 250 S.E.2d at 238. When the forest was acquired in 1934, the attorney general expressed his opinion that it should be tax exempt. The lease was executed in 1945, and amended to give the lessee control in 1951, but it was not until 1969 that the attorney general decided that the forest was no longer tax exempt. *Id.* at 331-33, 250 S.E.2d at 238-39.

65. *Id.* at 332, 250 S.E.2d at 238.

66. *Id.* at 338, 250 S.E.2d at 241.

67. *Id.* at 339, 250 S.E.2d at 241-42.

68. Although the exclusive use issue was determinative, the Foundation's arguments for exemption also failed on other grounds. N.C. GEN. STAT. § 105-275 (Cum. Supp. 1977), for example, requires that exempt property be held and used exclusively as a protected natural area. The court said that the forest was not such an area "due to the extensive program of road building, construction of drainage ditches and fire lanes, site preparation . . . , leasing of hunting rights . . . , and the cutting of timber and pulpwood." 296 N.C. at 339, 250 S.E.2d at 242.

owned by the University of North Carolina under G.S. 116-16.⁶⁹ Although North Carolina State University was represented on the foundation's Board of Directors,⁷⁰ and was to receive the Foundation's assets upon dissolution,⁷¹ the university had neither legal nor beneficial ownership of the forest.⁷²

Prior North Carolina decisions clearly support the court's construction of the exemption statutes involved in this case. In determining whether property falls within a tax exemption provision, the primary or dominant use, and not an incidental or secondary use, will control.⁷³ Even property owned by the state or a municipal corporation will not be accorded tax exempt status when it enters the realm of commercial use.⁷⁴ In this case, the lease permitted the Foundation to use the property for educational and scientific purposes only upon the condition that such use not interfere with the operations of the corporate lessee.⁷⁵ The dominant use of the forest was clearly commercial, therefore, since the corporation's right to cut timber and pulpwood took precedence over the Foundation's use.⁷⁶

Although the court's construction of the applicable exemption statutes cannot be faulted, the tax structure that mandated such a result deserves scrutiny. The North Carolina Constitution specifies that the legislature may only exempt from ad valorem taxation "property held for educational, scientific, literary, cultural, charitable, or religious purposes."⁷⁷ From 1969 through 1973 the Foundation was authorized by statute to pay ten cents per acre in lieu of the standard ad valorem tax on similar real property.⁷⁸ A comment accompanying the 1973 repeal⁷⁹

69. N.C. GEN. STAT. § 116-16 (1972); see 296 N.C. at 340, 250 S.E.2d at 242.

70. 35 N.C. App. 414, 430, 242 S.E.2d 492, 502 (1978). The court of appeals also noted that the Foundation's Board of Directors "is in no way controlled by North Carolina State University and apparently has the power to act without regard to the wishes of the University." *Id.*

71. *Id.*

72. 296 N.C. at 340, 250 S.E.2d at 242.

73. See *Redevelopment Comm'n v. Guilford County*, 274 N.C. 585, 593, 164 S.E.2d 476, 481 (1968).

74. *Id.* at 589, 164 S.E.2d at 479.

75. 296 N.C. at 333, 339, 250 S.E.2d at 238-39, 242.

76. *Id.* at 339, 250 S.E.2d at 241-42.

77. N.C. CONST. art. V, § 2, cl. 3.

78. 296 N.C. at 340, 250 S.E.2d at 239. This option was available under Law of July 1, 1969, ch. 185, § 1, 1969 N.C. Sess. Laws 1365 (formerly codified at N.C. GEN. STAT. § 105-279(b)). The section was repealed by Law of May 22, 1973, ch. 668, § 1, 1973 N.C. Sess. Laws 994. The provision allowed any corporation, trust, foundation, association or other entity that owned timberland and was organized and operated exclusively to receive, hold, invest and administer property and to make expenditures for the sole benefit of an educational institution, to pay to the county in which the timberland was located 15% of the proceeds of the gross sales of forest products or 10¢ per acre per year, whichever was greater.

of this "in lieu of" option noted that the provision was clearly unconstitutional.⁸⁰ The option failed to comport with the constitutional stricture that the purpose for which real property is held controls the legislative grant of exemptions. Although the "in lieu of" provision did not purport to exempt real property, it did allow imposition of an insignificant tax on timberland without regard to the purpose for which the land was held. Under the option, the Foundation's tax liability for the 81,000 acre forest was only \$8,100 per year, even though the forest was used primarily for commercial purposes. After repeal of the option, and with no "exclusive use" exemption available, the Foundation's 1974 tax liability for the 51,000 acres located in Onslow County was \$25,466.40.⁸¹ The large discrepancy between the two tax liabilities illustrates that the "in lieu of" provision was tantamount to an exemption and was, therefore, subject to the constitutional restriction. Because it did not comply with the restriction, it was properly repealed. Its repeal signified that the Foundation and others owning timberland used commercially must bear their share of the tax burden, even if they expend revenues derived from a commercial use for the sole benefit of an educational institution.

D. Income Tax

The second session of the 1977 legislature enacted the Manufacturer's Income Tax Credit Act.⁸² The Act provides an inventory tax credit against state income taxes for manufacturers who maintain excessive levels of inventories in the state.⁸³ Generally, manufacturers will qualify for the credit if their inventory exceeds fifteen per cent of their total cost of manufacturing.⁸⁴

The tax credit applies against the income tax due for the year in which the applicable inventory tax is paid.⁸⁵ Although excess credits and losses may be carried forward five years, the carry-forward must be used in the earliest taxable year possible and to its maximum extent before any excess credit may be carried forward to a later taxable

79. Law of May 22, 1973, ch. 668, § 1, 1973 N.C. Sess. Laws 994.

80. H. LEWIS, 1973 SUPPLEMENT TO THE ANNOTATED MACHINERY ACT OF 1971, at 69 (Institute of Government, University of North Carolina at Chapel Hill, 1973).

81. 35 N.C. App. 414, 418, 242 S.E.2d 492, 495 (1978). The liability to Jones County for the 31,000 acres located there is not revealed in the opinion.

82. N.C. GEN. STAT. § 105-163.01 to .02 (Interim Supp. 1978).

83. *Id.* § 105-163.03. The credit applies against taxes due for tax years beginning on or after January 1, 1980.

84. *Id.*

85. *Id.* § 105-163.03(8)(b).

year.⁸⁶ The manufacturer must file with his income tax return documentation supporting the availability of the credit.⁸⁷

The inventory tax credit was designed to attract heavy industry to North Carolina. Because the statute does not provide an across-the-board credit for all manufacturers, many smaller North Carolina companies that have long supported local communities by providing employment and expanding the tax base will not qualify for the credit. Were the credit extended to all manufacturers, however, the revenue loss might well be burdensome. The justification for the limited credit is that the revenue loss expected when the current statute becomes effective will be offset eventually by additional tax revenues from companies that relocate in North Carolina. Whether heavy industry will indeed be attracted by another tax concession is debatable.

Of the many factors that influence a business' decision to locate in a particular area, state and local taxation may be the least significant. Studies of the effect of taxation on industrial location reveal that markets, sources of raw materials, and labor supply are the major determinants of location decisions for most businesses.⁸⁸ Not only do tax incentives not dominate business location decisions, but the benefits new industry brings to a state may well "prove less than their fiscal, social, and environmental costs."⁸⁹ Also, any benefits may be short-lived because all state governments can employ tax incentives. Existence of a tax concession in one state may spur neighboring states to offer concessions that are even more attractive. It is conceivable that competing states may end up with a less productive, less equitable tax structure without realizing the benefits of industrial expansion.⁹⁰

Additionally, any tax concession to attract business must be considered in light of state tax policy, which has broader objectives than mere attraction of business. A fundamental tax policy is fairness in apportioning tax burdens, and a tax reduction for some will result in higher taxes for others. Tax equity is, therefore, sacrificed to the extent that some are singled out for preferential treatment.⁹¹

Any criticism of tax incentives does not mean that such incentives

86. *Id.*

87. *Id.* § 105-163.03(8)(d), .04.

88. C. Liner, *Taxation and Industrial Location* (June 1, 1976) (unpublished article in University of North Carolina Law School Library).

89. G. CORNIA, W. TESTA & F. STOCKER, *STATE-LOCAL FISCAL INCENTIVES AND ECONOMIC DEVELOPMENT*, at iii (Academy for Contemporary Problems 1978).

90. *See id.* at 17.

91. *See id.* at 3, 18.

should never be used to attract business. It should, however, suggest that tax concessions alone will do little to attract industry. Businesses desiring to expand or relocate are more interested in the cost and availability of labor, raw materials and energy than in tax differentials.⁹²

ALICE M. PETTEY

XI. TORTS

A. *Malpractice*¹

The court of appeals, in *Ballenger v. Crowell*,² a medical malpractice action, considered issues of first impression concerning contribu-

92. C. Liner, *supra* note 88, at 5. Liner's conclusion rests on the location theory, which assumes that "firms try to choose the location that maximizes total profit." *Id.* at 2. The factors likely to have the greatest impact on total profit are, therefore, the major determinants of business location under this theory. "For most firms, tax differentials are less important determinants because they have a small effect on total profit, are partly offset by income tax deductibility, and are often offset by such other considerations as local amenities and quality of public services." *Id.* at 5.

1. In *Chicago Title Insurance Co. v. Holt*, 36 N.C. App. 284, 244 S.E.2d 177 (1978), the North Carolina Court of Appeals held that claims for attorney malpractice sound in contract rather than tort. *Id.* at 288, 244 S.E.2d at 180. Plaintiff insurance company, relying on waivers of mechanics' and laborers' liens signed by defendant contractor, issued certain title insurance policies. Prior liens were later discovered on the property and plaintiff was required to make payment. The insurance company sued Holt on the basis of indemnity agreements in the lien waivers. Holt, in turn, filed a third-party complaint against the attorneys who had certified title to the insurance company alleging that the attorneys had failed to use reasonable care in determining the existence of unpaid lien creditors. Thus it was not the attorney's client who sued the attorney for malpractice but rather a third party.

In areas involving malpractice by other types of professionals, North Carolina courts have clearly recognized that the malpractice claim sounds in tort. Medical malpractice actions are an example of this approach. See text accompanying notes 21-28 *infra*. Additionally, in *Perfecting Servs. Co. v. Product Dev. & Sales Co.*, 261 N.C. 660, 136 S.E.2d 56 (1964), in which defendant design engineer was sued for negligence in the design of a mechanical model, the court found that industrial design is a profession and held that the professional "may incur liability in tort by reason of negligent performance." The reason the attorney malpractice claim did not sound in tort is not evident. Perhaps the court feared unlimited liability for attorneys if they were vulnerable to claims from those not in privity of contract. Perhaps the choice was the court's way of ensuring the "right" outcome in a case involving unusual facts. For a suggestion that the choice is based on desired outcome, see Averill, *Attorney's Liability to Third Persons for Negligent Malpractice*, 2 LAND & WATER L. REV. 380, 381 (1967). But the result is unsatisfactory for it leaves certain elements of the action under contract law, *e.g.*, damages, while other elements, such as causation and duty of care, must, presumably, still be determined under tort law. For further discussion of *Holt*, see this Survey, *Commercial Law: Contracts*.

2. 38 N.C. App. 50, 247 S.E.2d 287 (1978).

tory negligence and limitation of actions.³ Plaintiff had a chronic neurological disease for which defendant doctor began to treat him in 1960. Although the standard treatment for plaintiff's disease was surgery, defendant instead treated him with medication for the pain. Plaintiff, as a result, became addicted to morphine in 1962. Plaintiff knew that he was addicted, but believed that the treatment was proper and necessary because the doctor had so informed him. He continued under defendant's care until 1974, and during this entire period defendant continued to treat him with morphine. In 1974 plaintiff consulted other doctors, left defendant's care, and began treatment for the drug addiction.⁴ Plaintiff sued defendant for malpractice and defendant, by way of defense, claimed that plaintiff was contributorily negligent in accepting his addiction.

The court held that plaintiff was not contributorily negligent as a matter of law,⁵ relying on the general rule that a patient has a right to trust in his doctor's skill and judgment and will not be found guilty of contributory negligence for so doing.⁶ Thus, a patient is not contributorily negligent for continuing his treatment when he knows that he has become an addict, unless he knows of the doctor's negligence or he himself does something wrong.⁷ The facts in this case are quite the opposite of the situation in which a patient refuses to follow his doctor's instructions and thus causes himself further injury. When a patient relies on his doctor's judgment and is aware that the treatment is causing him injury, but is not aware that this is due to the doctor's negligence, he will not be barred from recovery because of his supposed contributory negligence.

The *Ballenger* decision is in line with the few cases presenting analogous fact situations cited by the court. In both *King v. Solomon*⁸

3. For discussion of the court's treatment of limitation of actions, see text accompanying notes 11-17.

4. 38 N.C. App. at 51-53, 247 S.E.2d at 289-90.

5. *Id.* at 56, 247 S.E.2d at 292.

The very relation [between doctor and patient] assumes trust and confidence on the part of the patient in the capacity and skill of the physician; and it would indeed require an unusual state of facts to render a person who is possessed of no medical skill guilty of contributory negligence because he accepts the word of his physician and trusts in the efficacy of the treatment prescribed by him.

Id.

6. *Cf. Kelly v. Carroll*, 36 Wash. 2d 482, 219 P.2d 79 (1950) (patient's reliance on defendant drugless healer found not to be contributory negligence when patient died after defendant negligently misdiagnosed and treated him for appendicitis). *Id.* at 501, 219 P.2d at 90.

7. 38 N.C. App. at 55, 247 S.E.2d at 291.

8. 323 Mass. 326, 81 N.E.2d 838 (1948), cited in *Ballenger v. Crowell*, 38 N.C. App. at 55, 247 S.E.2d at 291.

and *Los Alamos Medical Center v. Coe*,⁹ plaintiff patient became addicted to morphine because of defendant doctor's negligent treatment. In both cases, even though the patient knew of the addiction and sought more medication, it was held that the patient had the right to rely on the doctor's expertise and was, therefore, not liable for failing to question the treatment.

B. *Limitation of Actions*

Ballenger also dealt with statute of limitations problems in medical malpractice actions. The court held that there may be a continued course of treatment exception to the general rule that malpractice actions accrue at the time of the defendant's negligence.¹⁰ Defendant claimed that plaintiff's cause of action accrued in 1962 when he became addicted to morphine and was thus barred by the statute of limitations. Plaintiff claimed that the action accrued in 1974 when he ended the doctor-patient relationship with defendant. The court, agreeing with plaintiff, held that "the cause of action accrued at the earlier of (1) the termination of defendant's treatment of the plaintiff or (2) the time at which the plaintiff knew or should have known of his injury."¹¹

In reaching its decision, the court reviewed the statutes of limitations governing malpractice actions as well as related case law. G.S. 1-15(b),¹² which concerns injuries not readily apparent, was found to be inapplicable since the injury in this case was patent. G.S. 1-15(c),¹³ a subsection specifically concerning professional malpractice actions that was added by the 1975 amendment of G.S. 1-15, was also inapplicable because the case was pending when the amendment was enacted. Because these were the only special statutes that might have been applicable, the question before the court was whether North Carolina recognizes a common law continued course of treatment exception to the general three-year statute applicable in civil actions.¹⁴

The court then proceeded to review case law relating to limitation of actions in medical malpractice cases, beginning with *Shearin v. Lloyd*.¹⁵ In that case, the North Carolina Supreme Court held that the

9. 58 N.M. 686, 275 P.2d 175 (1954), cited in *Ballenger v. Crowell*, 38 N.C. App. at 55, 247 S.E.2d at 291.

10. 38 N.C. App. at 59, 247 S.E.2d at 294.

11. *Id.* at 60, 247 S.E.2d at 294.

12. N.C. GEN. STAT. § 1-15(b) (Cum. Supp. 1977).

13. *Id.* § 1-15(c) (Cum. Supp. 1977).

14. *Id.* § 1-52 (Cum. Supp. 1977).

15. 246 N.C. 363, 98 S.E.2d 508 (1957).

cause of action accrues and the statute of limitations begins to run from the time of defendant's wrongful act, and *not* from the time when plaintiff patient discovers the injuries caused by the act. The *Shearin* court thus rejected the discovery rule exception¹⁶ under which the cause of action is held not to accrue until the time of discovery of the harmful consequences of the doctor's negligence.¹⁷

Shearin, however, unlike *Ballenger*, involved a latent injury caused by the doctor's single act of negligence in leaving a foreign object in plaintiff's body. Because the continuing course of treatment exception does not apply to such circumstances, the question whether North Carolina recognizes a continued course of treatment exception was not before the *Shearin* court. The *Shearin* court's affirmance of the general rule that the cause of action accrues at the time of defendant's wrongful act did not therefore bar the *Ballenger* court from adopting the continuing course of treatment exception.¹⁸

G.S. 1-15(a) has now statutorily overruled *Shearin* by enacting a discovery rule exception. This provision provides for accrual of the cause of action in cases of latent injury at the time of discovery of the injury, but in no case later than four years (ten years when damages are sought by reason of a foreign object being left in the body) from the last act of defendant giving rise to the cause of action.¹⁹ Because the *Ballenger* rule applies to different circumstances than does the discovery rule, there is no conflict between the four year outer limit in G.S. 1-15(c) and the absence from the *Ballenger* rule of any similar limit. In cases in which there is an ongoing doctor-patient relationship and a continuing course of treatment, that the injury is not discovered until more than four years after infliction will not bar the action so long as the injurious course of treatment continues.

Although referred to as an exception, the continuing course of treatment rule adopted in *Ballenger* may actually create no exception at all. The factual pattern that lies behind the *Ballenger* rule appears to be one in which there is negligent treatment throughout the entire course of the doctor-patient relationship. The "exception" apparently does not apply when a single negligent act is followed by continued treatment; rather, it applies when the entire course of treatment is neg-

16. N.C. GEN. STAT. § 1-15(b), (c) (Cum. Supp. 1977) now supplies a statutory discovery rule exception.

17. *Jones v. Sugar*, 18 Md. App. 99, 105, 305 A.2d 219, 222 (1973).

18. *See* 38 N.C. App. at 57-58, 247 S.E.2d at 293.

19. N.C. GEN. STAT. § 1-15(c) (Cum. Supp. 1977).

ligent.²⁰ In this situation the entire treatment is tortious, and the negligence constitutes a continuing tort.²¹ Thus

the [negligent] treatments were not separate and distinct acts, separate and distinct causes of action. They constituted an entire course of treatment . . . and the whole thereof constituted but one cause of action. . . . [T]he tort was a continuing one, and, where the tort is continuing, the right of action is also continuing.²²

On these facts, then, there is no completion of defendant's wrongful act until the doctor-patient relationship is terminated. When the relationship ends and the wrongful act is completed, the cause of action accrues. This simply seems to be an extension of the general rule that the cause of action accrues at the time of defendant's wrongful act.

Moreover, interpretation of the second prong²³ of the continuing course of treatment "exception" creates some difficulty. That requirement provides that the statute of limitations will begin to run before the end of the course of treatment if the patient discovers the injury. But "discovery of the injury" could mean discovery of the actual physical injury itself or it could mean discovery of defendant doctor's negligence in causing the injury. The *Ballenger* court apparently applied the latter interpretation.²⁴ This ambiguity may cause conflicts in construction of the statutory discovery rule of G.S. 1-15(b) and (c).

Whichever interpretation is intended, it is clear that the *Ballenger* court accepts the discovery rule within the context of the continued course of treatment "exception." In this context the discovery rule acts to reduce the period of limitations. This approach accords with the policies behind the statute of limitations, which are "to prevent stale claims and to protect potential defendants from protracted fear of litigation."²⁵

In *Ward v. Hotpoint Division, General Electric Co.*,²⁶ the court of appeals attempted to clarify prior law concerning accrual of actions in cases involving nonapparent defects in property that cause injury at some later time. Plaintiffs sued for damages resulting from a fire in a shopping center in 1969. The fire was allegedly caused by a negligently

20. *See Tortorello v. Reinfeld*, 6 N.J. 58, 66, 77 A.2d 240, 244 (1950).

21. *See* Annot., 144 A.L.R. 209, 227 (1943).

22. *Peteler v. Robinson*, 81 Utah 535, 549, 17 P.2d 244, 249 (1932).

23. *See* text accompanying note 11 *supra*.

24. 38 N.C. App. at 60, 247 S.E.2d at 294. The court found that there was conflicting evidence about whether plaintiff knew that the medication provided by defendant was not necessary and held that this was a question for the jury on remand.

25. *Id.* at 59, 247 S.E.2d at 294.

26. 35 N.C. App. 495, 241 S.E.2d 710, *cert. denied*, 295 N.C. 94, 244 S.E.2d 263 (1978).

designed deep fat fryer that was manufactured and sold by defendant in 1962 to a company that was not a party to the action. Defendant claimed that the suit was barred by the statute of limitations because the action accrued in 1962 when the fryer was sold. The court, however, upheld plaintiffs' claim that there was no accrual of their cause of action until the time of the actual injury in 1969.²⁷

As in *Ballenger*, G.S. 1-15(b) was found to be inapplicable because it concerns situations in which there is an injury that is not readily apparent to plaintiff. The court found that there was no injury at all to plaintiffs in this case until the time of the fire, and that that injury was readily apparent.²⁸ The court's examination of case law revealed that there are two lines of cases in North Carolina dealing with accrual of actions when a latent defect later causes injury to person or property. The line of cases represented by *Hocutt v. Wilmington & Weldon R.R.*,²⁹ *Rafferty v. Vick Construction Co.*,³⁰ and *Pinkston v. Baldwin, Lima, Hamilton Co.*³¹ provides that the cause of action accrues at the time of the actual injury. On the other hand, *Hooper v. Carr Lumber Co.*,³² *State v. Cessna Aircraft Corp.*,³³ and *Jarrell v. Samsonite Corp.*³⁴ provided that the cause of action accrues at the time of defendant's wrongful act or omission. The court of appeals in *Ward* followed the *Hocutt* rule and relied on the holding that

the cause of action accrues and the statute of limitations begins to run at the time of actual injury to a plaintiff who is not in privity with the manufacturer or seller of defective goods and thus suffered no technical or slight injury at the time of the sale of the goods.³⁵

There is usually no conflict between the *Hooper* and the *Hocutt* rules because the act and the injury are simultaneous. In cases in which the injured plaintiff is in privity with the defendant seller or manufacturer, for instance, defendant's wrongful act and the injury oc-

27. *Id.* at 496-97, 241 S.E.2d at 711-12.

28. *Id.* at 500, 241 S.E.2d at 713.

29. 124 N.C. 214, 32 S.E. 681 (1909) (diversion of water through defendant's ditches caused flooding of plaintiff's land many years after ditches dug).

30. 291 N.C. 180, 230 S.E.2d 405 (1976) (plaintiff's messare killed when hit on head by part of crane manufactured by defendant's predecessor more than three years before injury).

31. 292 N.C. 260, 232 S.E.2d 431 (1977) (plaintiff's messare killed when crane manufactured by defendant fell).

32. 215 N.C. 308, 1 S.E.2d 418 (1939) (defendant's logging operations caused flooding of plaintiff's land).

33. 9 N.C. App. 557, 176 S.E.2d 796 (1970) (plaintiff's building damaged when engine of plane manufactured by defendant fueled and plane crashed into building).

34. 12 N.C. App. 673, 184 S.E.2d 376 (1971), cert. denied, 280 N.C. 180 (1972) (plaintiff customer in restaurant injured when she fell from defective chair manufactured by defendant).

35. 35 N.C. App. at 499-500, 241 S.E.2d at 713.

cur at the same time, because the sale of a defective product constitutes the first injury to the plaintiff buyer.³⁶ Difficulties arise, however, in determining the time of accrual of the cause of action when the plaintiff injured by the defective product is *not* in privity with the defendant seller. In this situation the injury and defendant's wrongful act are not simultaneous because no technical injury arises at the time of the sale.

As recognized by *Ward*, in the latter circumstances it is usually determined that the cause of action accrues when actual injury occurs. This comports with the general rule in North Carolina, as discussed above in relation to medical malpractice cases, which provides that a cause of action accrues at the time of defendant's wrongful act that causes injury to the plaintiff. The crucial moment is the one at which the first injury occurs. Between parties that are in privity even a technical injury is sufficient to begin the running of the statute. It is unimportant that the substantial damages do not occur until some later time.³⁷ With respect to a party not in privity with the seller, however, not until the defect actually causes substantial injury to that party is there an invasion of his rights and a cause of action. In the latter circumstances *Hooper*, nevertheless, provided that the cause of action accrued at the time of the wrongful act.

The court of appeals in *Ward*, however, follows the *Hocutt* rule and holds that in the nonprivity situation the statute of limitations does not begin to run until the time of the injury. It thus appears that, under the court's interpretation of these two cases, *Hooper* is not controlling in situations in which the wrongful act and the injury are not simultaneous.

C. Consortium

In *Cozart v. Chapin*,³⁸ the court of appeals held that a husband has no cause of action for loss of consortium resulting from injuries to his wife even when the injuries were intentionally inflicted.³⁹ Plaintiff wife sued defendant dentist alternatively on theories of negligence and assault and battery, and in conjunction with this action plaintiff husband

36. See *Thurston Motor Lines v. General Motors Corp.*, 258 N.C. 323, 128 S.E.2d 413 (1962).

37. See *Williams v. General Motors Corp.*, 393 F. Supp. 387 (M.D.N.C. 1975), *aff'd*, 538 F.2d 327 (4th Cir. 1976); *Mast v. Sapp*, 140 N.C. 533, 53 S.E. 350 (1906); Annot., 4 A.L.R.3d 821, 830 (1965).

38. 35 N.C. App. 254, 241 S.E.2d 144, *cert. denied*, 294 N.C. 736, 244 S.E.2d 154 (1978).

39. *Id.* at 255, 241 S.E.2d at 145-46.

sued for loss of consortium.⁴⁰

The *Chapin* court suggested that it might be time to reexamine the rule first established in *Hinnant v. Tidewater Power Co.*⁴¹ barring an action for loss of consortium due to injuries negligently caused the spouse by a third person. The court nevertheless proceeded to extend the rule by finding that a claim for loss of consortium is also barred when the injuries were *intentionally* inflicted. Under the court of appeals' reading of *Hinnant*, an action for loss of consortium might lie when there is intentional infliction of injury to consortium itself (as, for example, in cases of alienation of affections or criminal conversation), but not when there is an intentional infliction of some injury to the person of one's spouse causing loss of consortium.

D. Damages

In *Matthews v. Lineberry*⁴² plaintiff student was permitted to recover damages for loss of time from school and for repeating a course. Defendant claimed that there was no evidence of monetary loss or damages and that there could be no recovery because damages were too uncertain. The court, in upholding plaintiff's recovery, observed that rules on uncertainty of damages relate to uncertainty about the cause or fact of damages and not about their measure or extent.⁴³

It appears that these precise elements of damages have not before been claimed in North Carolina. As a general rule, however, "the fact that the full extent of the damages must be a matter of some speculation is no ground for refusing all damages."⁴⁴ Thus damages may be allowed even when it is not possible to calculate with precision the claimed item.

To some extent, one may analogize the present facts to the situation of lost work time. Although there is an immediate economic impact when one misses work and not when one loses time from school, loss of school time could have an economic impact at a later time. Moreover, a plaintiff is entitled to recover damages for prospective as well as past and present injuries.⁴⁵ Finally, not only may a plaintiff

40. As a result of a dental operation, plaintiff wife suffered severe paralysis in her lower lip and was experiencing numbness and tingling on contact. *Id.* at 255, 241 S.E.2d at 145.

41. 189 N.C. 120, 126 S.E. 307 (1925).

42. 35 N.C. App. 527, 241 S.E.2d 735, *cert. denied*, 295 N.C. 91, 244 S.E.2d 259 (1978).

43. *Id.* at 529, 241 S.E.2d at 737.

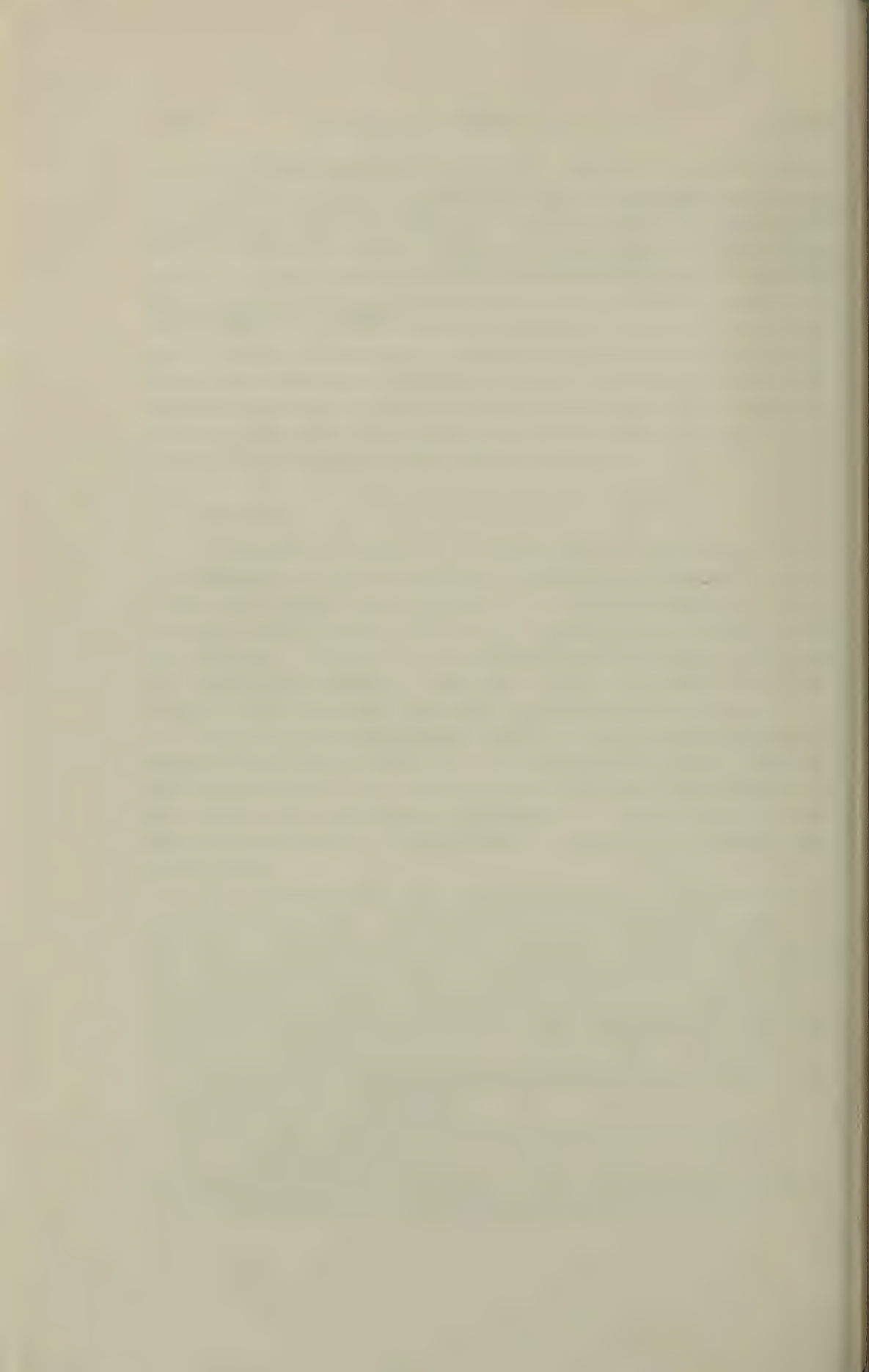
44. *Brown v. Moore*, 286 N.C. 664, 673, 213 S.E.2d 342, 349 (1975) (wrongful death action for death of 17-year-old boy).

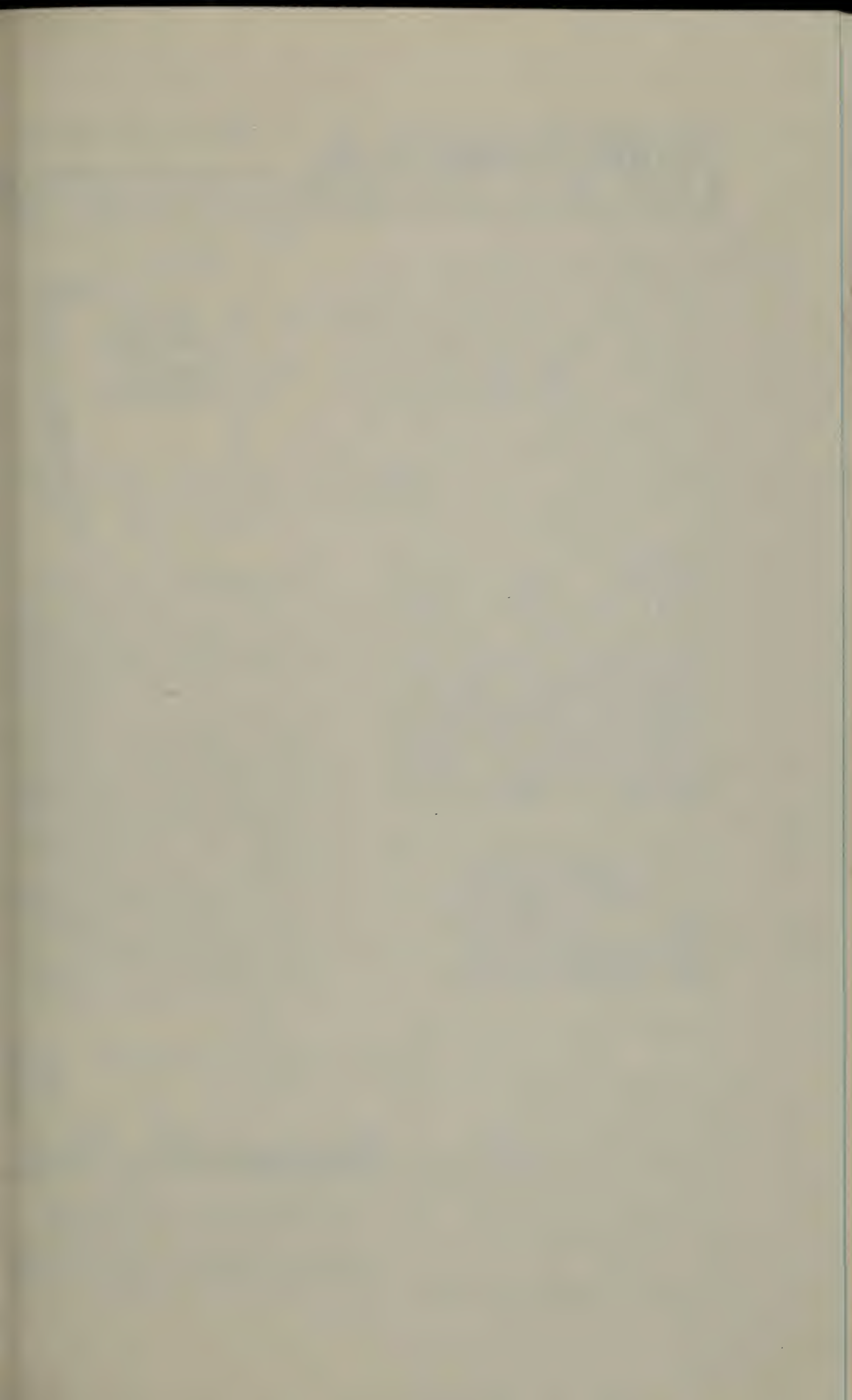
45. *King v. Britt*, 267 N.C. 594, 597, 148 S.E.2d 594, 598 (1966).

recover for loss of earnings, a plaintiff may also recover for "loss of time, or loss from inability to perform ordinary labor."⁴⁶ Certainly in this case plaintiff suffered a loss of time from school and an inability to perform ordinary school activities, and thus recovery for these losses is justified by the prevailing rules on damages.

SHERI A. VAN GREENBY

46. *Owens v. Kelly*, 240 N.C. 770, 773, 84 S.E.2d 163, 165 (1954).





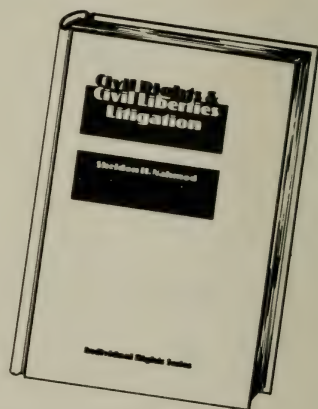
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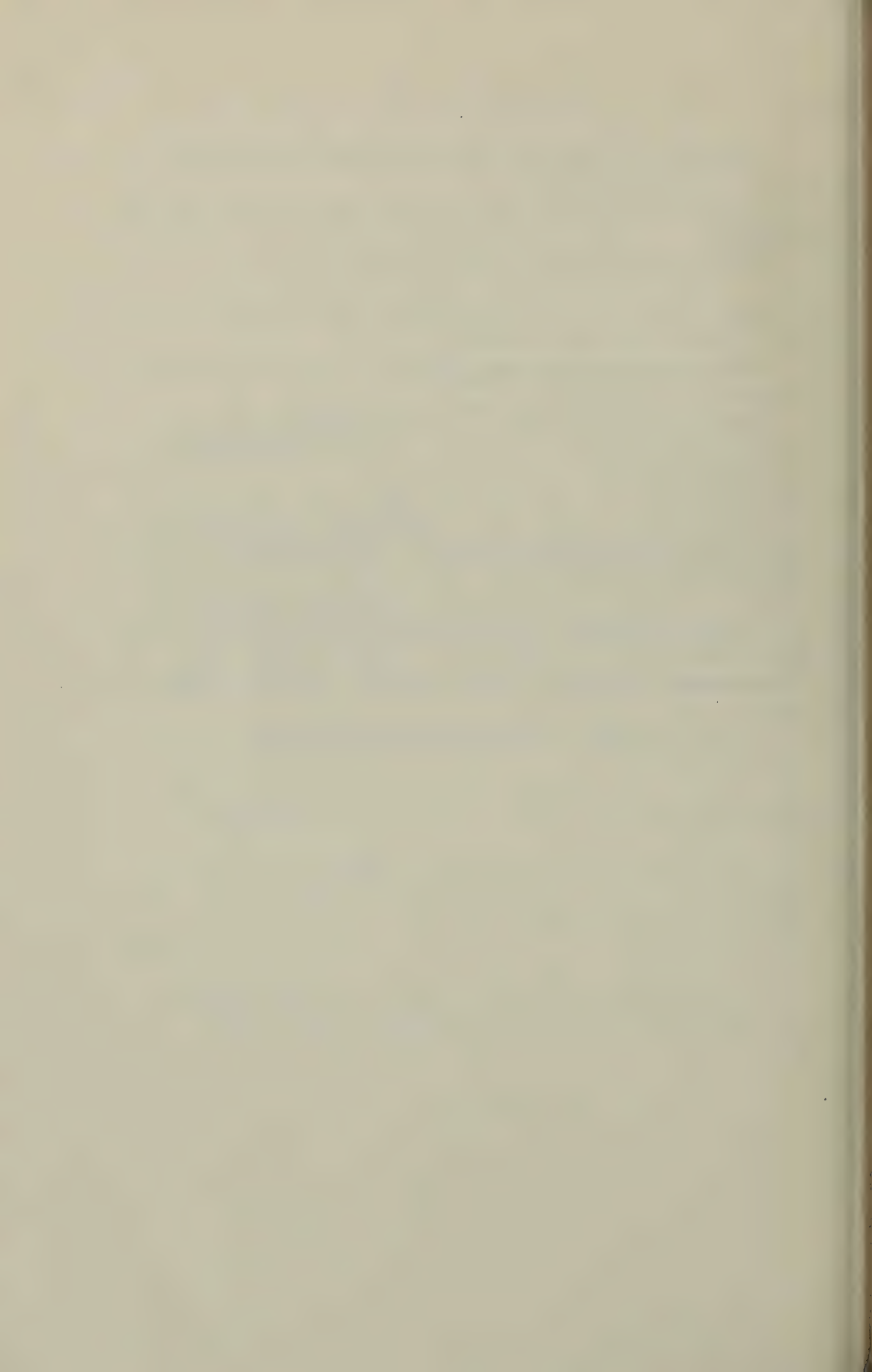
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INTRODUCTION

The delivery of health care began in the churches of the Medieval era and has grown to such proportions that today it can truly be described as an industry. Regulation of this industry, however, is still in its infancy. Until the early Sixties, the health care industry remained relatively free of government efforts to regulate the quality, cost or allocation of health care services. With the increased government funding of health care through such programs as Medicare and Medicaid, however, came the concomitant attempts to control the recipients of this largesse. Moreover, the runaway inflation of the Seventies has led to growing public concern about health costs, which has generally been translated into demands for even more government control. Because health facilities, primarily hospitals and nursing homes, have been the greatest contributors to rising health costs, regulatory strategies have understandably focused on these behemoths of the health care industry. Unfortunately, state regulation through, for example, the "certificate of need" program and federal regulation through, for example, the reimbursement policies and participation requirements of Medicare and Medicaid have so far had little demonstrable effect on either the costs of health care facilities or the quality of care that they provide.

The purpose of this symposium is both to examine the causes for the failure of efforts to regulate health facilities and to suggest some improvements in these regulatory efforts. The articles range from a theoretical discussion of the constitutional underpinnings of governmental regulation of health facilities to a practical guide on making "certificate of need" work. In most cases, the authors have drawn on their personal experiences with various state regulatory and financing agencies in analyzing the problems that they address. Because these experiences are used only as examples, however, the articles are relevant to all efforts to regulate health facilities. Furthermore, the common thread of federal legislation, which affects every level of regulation in this area, strengthens this broad applicability.

Perhaps the most important conclusion to be drawn from this symposium is that the answers to the present crisis in health facility regulation usually lie not in more regulation, but rather in more effective regulation. It is to be hoped that, through a greater understanding of the mechanisms of health facility regulation, agency staffs, the bar that practices before them, and the public that they serve will make more

effective use of existing regulatory programs in an effort to reduce the costs of health care facilities, improve the quality of care provided by those facilities and allocate wisely the resources available to them.

Finally, the *Review* would like to express its gratitude to Professor Kenneth R. Wing, who proposed this symposium and was instrumental in bringing it to fruition. In addition to co-authoring two of the articles that appear herein, Professor Wing has contributed his skills as a coordinator, an editor, and even a footnote checker, and the *Review* certainly appreciates his efforts.*

* The *Review* would also like to thank Leslie Brown and Kimberly Taylor Powell, both rising second year law students at The University of North Carolina and Professor Wing's research assistants, for their excellent assistance in checking footnotes for this symposium.

HEALTH CARE REGULATION: DILEMMA OF A PARTIALLY DEVELOPED PUBLIC POLICY

KENNETH R. WING †

BURTON CRAIGE ‡

Significant government attempts to regulate or control health facilities are remarkably recent phenomena. Except for state programs of health facility licensure,¹ which have generally required only that facilities meet minimal standards of quality and safety,² and the incidental planning activities associated with the Hill-Burton construction program,³ American health facilities have until recently been free from any serious government efforts to regulate the quality of patient care, affect the cost of services, or determine the allocation of resources. In the past decade, however, the increasing concern of the general public about the costs of health care⁴ and, more importantly, the concerns of local, state, and federal governments about the impact of health care

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1. See generally text accompanying notes 148-152 *infra*.

2. See A. SOMERS, HOSPITAL REGULATION: THE DILEMMA OF PUBLIC POLICY 118-32 (1969); Worthingham & Silver, *Regulation of Quality of Care in Hospitals: The Need for Change*, 35 LAW & CONTEMP. PROB. 305, 308 (1970).

3. See text accompanying notes 160-66 *infra*.

4. Estimates of the costs of health care in this country vary with the source of information relied upon and with the definition of health care used. The most often cited and among the most reliable statistics are those prepared by HEW and periodically published in SOCIAL SECURITY BULLETIN.

The most recent HEW estimates of national health expenditures indicate that the nation spent approximately \$163 billion for health care in fiscal year 1977. See Gibson & Fisher, *National Health Expenditures, Fiscal Year 1977*, SOC. SEC. BULL., July 1978, at 3, 5 (Table 1). This represents an increase of 12% over the spending for the previous year, and an increase from approximately 8.7% of the gross national product to 8.8%. *Id.* at 3.

These figures indicate a continuation of an inflationary trend that has extended over the last decade. Health care expenditures increased at an average annual rate of over 12% from 1965 to 1970, and have increased over 13% annually since 1970. *Id.* at 5 (Table 1).

Recent estimates indicate that spending for fiscal year 1978 may exceed \$180 billion and may reach over \$200 billion by 1980.

costs on government budgets,⁵ have created a political climate favoring increases in public control of health care in general and health facilities in particular.

Since 1964, thirty-eight states have attempted to regulate capital expenditures by health facilities through "certificate of need" programs.⁶ Federal efforts to establish health resource planning programs, originally billed as financial support for voluntary efforts,⁷ have increased and taken on a markedly regulatory character. The 1974 federal health planning legislation⁸ provides financial support for an elaborate scheme of state and local health planning agencies with the authority to influence, and in some cases to determine, federal funding decisions.⁹ The 1974 legislation also provides extensive authority to regulate capital expenditures by health facilities and related institutions.¹⁰ In addition, government reimbursement policies and the requirements of participation under Medicaid and Medicare have been used increasingly to influence facility costs,¹¹ maintain the quality of patient care,¹² and encourage, if not coerce, changes in the manner in which care is delivered.¹³

That the Ninety-Fifth Congress, under the urging of the Carter Administration, gave serious consideration to the imposition of mandatory cost controls for the nation's hospitals¹⁴ demonstrates both

5. As the overall costs of health care have inflated, so have the costs of government health care programs. Public spending for personal health services, primarily expenditures for the Medicare and Medicaid programs, exceeded \$57.1 billion in 1977 and represented over 40% of all spending for personal health care. *Id.* at 7 (Table 3). Of this total, about \$40 billion or 28% of the total cost of health care came from federal programs, and about \$17 billion or 12% came from state and local government. *Id.* at 7 (Table 3). This also is a continuation of an inflationary trend that began in 1965, the year that the Medicare and Medicaid programs were enacted. *Id.* at 5 (Table 1).

While the federal share is larger, inflation in government health care programs has had a serious impact on state and local governments as well. Federal health programs are now over 10% of federal spending. OFFICE OF MANAGEMENT AND BUDGET, THE BUDGET OF THE U.S. GOV'T: FISCAL YEAR 1978, at 52; state expenditures for health average over 7% of state budgets, *see* BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 303 (Table 489) (1978).

6. *See* text accompanying notes 176-79 *infra*.

7. *See* text accompanying notes 173-75 *infra*.

8. National Health Planning and Resources Development Act of 1974, 42 U.S.C. §§ 300k-300t (1976).

9. *Id.* § 300l-2(e)(1)(A).

10. *See id.* § 300m-2(a)(4)(A).

11. *See* Wing & Sifton, *Constitutional Authority for Extending Federal Control Over the Delivery of Health Care*, this Symposium, at notes 11 & 12 and accompanying text.

12. *Id.* at text accompanying note 30.

13. *See* text accompanying notes 155-200 *infra*.

14. *See* Wing & Sifton, this Symposium, at note 41.

the emerging importance of the health care cost problem and the recent dramatic change in the nation's political attitudes towards government regulation of health care providers.

While concern about rising costs has resulted in a climate that is favorable to regulation, it is not clear that regulation is the most appropriate response. Indeed, some experts argue that public policy should be quite the opposite¹⁵ and that government should intervene in the health care industry only to the extent necessary to ensure that there is an adequate level of competition among health care providers and that market forces control cost. These free market theorists contend that public regulation will only exacerbate inflation, stifle competition and innovation, and result in a less rational distribution of facilities and resources.

Whatever the merits of market solutions, both state and federal governments have shown a preference for regulatory strategies. Until those strategies prove to be unworkable, it is unlikely that there will be a major shift in this policy. Quite to the contrary, current legislative and administrative proposals do not involve choices between regulation and (enforced) competition; the only consideration is whether to extend regulation beyond current programs. There is still substantial political support for maintenance of the basically private character of the health care industry and, as the defeat of hospital cost containment demonstrates, there are limits on our willingness to extend government control.¹⁶ It is clear, however, that we have entered an era in which government is seeking to extend its influence over health care delivery by expanding the scope of existing controls and making existing regulatory mechanisms more effective.

It is, therefore, appropriate to examine existing regulatory controls in an attempt to assess their successes and to reflect on the future of public control. Before examining particular experiences with regulation, however, it is necessary to look at the nature of the industry itself and the history of government intervention. Critical evaluation of regulatory strategies is impossible without a basic understanding of the affected institutions, the role they play in service delivery and their

15. Strong arguments have been made, in both public debate and in the literature, in favor of an "antitrust" approach to controlling health care costs, and the current trend towards government regulation is sometimes criticized as both ineffective and philosophically inappropriate. For a collection of recent articles on this topic, see *Symposium on the Antitrust Laws and the Health Services Industry*, 1978 DUKE L.J. 303. For a good summary of related references see Havighurst, *Professional Restraints on Innovation in Health Care Financing*, 1978 DUKE L.J. 304, 304 n.1.

16. See Wing & Sifton, this Symposium, at text accompanying notes 65-69.

financial structure. Equally important is an understanding of the historical context out of which the current regulatory efforts have emerged and the peculiar character of the programs that have evolved.

I. THE HEALTH CARE INDUSTRY

The American health care delivery system is composed of a variety of public and private, individual and institutional actors, linked by complex and rapidly changing financial and administrative arrangements.¹⁷ Regulatory efforts have been directed primarily at *institutional* providers of health services. *Individual* providers (physicians, pharmacists, dentists) have for the most part remained free from government control.

Political considerations account for the relative immunity enjoyed by individual providers. Well-organized associations of health professionals, traditionally dominated by conservative fee-for-service practitioners, have drawn from a large reservoir of public trust, as well as private finances, in their struggle to resist public control.¹⁸ And while opposition to regulation has been stronger among individual, as opposed to institutional, providers, the need for public intervention has not seemed as urgent. As more (and more expensive) services are rendered in institutional settings, individual providers are responsible for a declining proportion of total health care costs.¹⁹

This analysis will reflect current regulatory priorities and concentrate on institutional providers, specifically hospitals and nursing homes. Together, these institutions account for half of the total health-related expenditures.²⁰ During the past fifteen years hospitals and nursing homes have experienced spectacular growth and have increas-

17. See generally HEALTH CARE DELIVERY IN THE UNITED STATES (S. Jonas ed. 1977); F. WILSON & D. NEUHAUSER, HEALTH SERVICES IN THE UNITED STATES (rev. ed. 1976).

18. R. ALFORD, HEALTH CARE POLITICS: IDEOLOGICAL AND INTEREST GROUP BARRIERS TO REFORM (1975); R. HARRIS, A SACRED TRUST (1966); E. RAYACK, PROFESSIONAL POWER AND AMERICAN MEDICINE (1967); Comment, *The American Medical Association: Power, Purpose, and Politics in Organized Medicine*, 63 YALE L.J. 937 (1954).

19. See text accompanying notes 41-43 *infra* (noting decline in proportionate expenditures for physicians' services). Dentists and pharmacists also receive a smaller share of health expenditures than they once did. The proportion of total health expenditures for dental services declined from 13.3% in 1929 to 6.2% in 1977; expenditures for drugs consumed 16.7% of the total in 1929 and only 7.7% in 1977. Gibson & Fisher, *supra* note 4, at 15 (Table 5).

20. In the fiscal year ending September 1977, expenditures for hospital care totalled \$65.6 billion. Nursing home care expenditures were \$12.6 billion. These figures represented 40.4% and 7.8%, respectively, of total national health expenditures. An additional 3.1% (\$5.1 billion) was spent on medical facilities construction, much of it for hospitals and nursing homes. Gibson & Fisher, *supra* note 4, at 15 (Table 5).

ingly become the objects of critical public attention. Discussions of regulation, however, all too often ignore the variety of forces and actors within the regulated sector. An overview of the development, structure and dynamics of the hospital and nursing home industries will at least suggest the complexity of the regulatory task.

A. Hospitals

Ten years ago an astute observer wrote,

The hospital is to modern America what the cathedral was to Europe in the Middle Ages: a complex social institution serving simultaneously a variety of purposes—welfare center, object of civic pride, major source of employment, market for artists, artisans, and architects, inspirer of saintly deeds and beneficiary of repentant sinners, occasional “cover-up” for hypocrites and exploiters, source of power, and object of political conflict.²¹

In the last decade the hospital has assumed even greater importance. Provider of a growing array of services, consumer of an increasing proportion of resources, it has solidified its dominant position in the American health care system. At the same time, it has become the focus of ever more intensive scrutiny and criticism. As the belief in technological salvation declines, its institutional embodiment, the hospital, can no longer depend on the veneration of the faithful to protect it from public control.

Only relatively recently have hospitals been identified with medical cure for the acutely ill. The medieval hospital, operated by the Church, provided a refuge for the poor, the aged, the homeless and the sick. Its purpose was more philanthropic and spiritual than medical.²² In the sixteenth century, the hospital was secularized and subjected to governmental authority.²³ While its mission was reformulated in social terms, it retained its character as a shelter for the unfortunate, with only an incidental medical function.²⁴

In the late eighteenth and early nineteenth centuries, English and American hospitals began to assume more specialized roles. Private “voluntary” hospitals, financed by subscription and bequest, arose to

21. A. SOMERS, *supra* note 2, at ix.

22. Rosen, *The Hospital: Historical Sociology of a Community Institution*, in *THE HOSPITAL IN MODERN SOCIETY* 1, 2-13 (E. Freidson ed. 1963).

23. *See id.* at 13-19.

24. In 1551 a council of citizens set admissions quotas for St. Thomas' Hospital in London: 300 orphans, 400 aged, 650 “decayed householders,” 200 idle vagabonds, 350 “poor men overburdened with children” and 20 “sore and sick persons.” J. FREYMAN, *THE AMERICAN HEALTH CARE SYSTEM: ITS GENESIS AND TRAJECTORY* 21-22 (1974).

supplement and supplant the public institutions. The voluntary hospital provided care for patients who had some prospect of recovery. The incurables, the insane, the blind and those with infectious diseases were sent to public almshouses.²⁵

The early hospitals, both public and private, catered almost exclusively to the poor. Patients with adequate means were treated by their physician at home. The abysmal hygienic conditions, the overcrowding of the wards and the primitive state of medical knowledge made the hospital the choice of only the most desperate.²⁶

In the latter part of the nineteenth century, scientific advances transformed the institution. Surgical anesthesia and asepsis, new diagnostic and therapeutic techniques, and improved standards of general hygiene reduced hospital mortality rates. In 1900 a patient admitted to a general hospital had for the first time a better than even chance of leaving alive.²⁷ The public began to view the institution as a place of hope rather than despair. The rate of growth was astonishing: in 1873 there were only an estimated 178 hospitals in the United States; by 1909 there were 4,359.²⁸

Although hospitals proliferated in the early part of this century, the solo medical practitioner remained the dominant actor in the health care system.²⁹ It was only after World War II that several forces converged to effect another fundamental change in the institution and to shift the balance of power from the private physician to the modern hospital industry.³⁰ Rapid advances in medical knowledge and technology caused patient care to become more fragmented and costly.³¹ Physicians increasingly relied on hospital facilities and resources to supplement their own services.³² The growth of Blue Cross plans³³ and the postwar boom in commercial health insurance,³⁴ typically covering

25. *Id.* at 22-24; Rosen, *supra* note 22, at 24-25.

26. Rosen, *supra* note 22, at 26, 29-30.

27. Enright & Jonas, *Hospitals*, in *HEALTH CARE DELIVERY IN THE UNITED STATES* 164, 166 (S. Jonas ed. 1977).

28. *Id.* (citing R. STEVENS, *AMERICAN MEDICINE AND THE PUBLIC INTEREST* 52 (1971)).

29. B. EHRENREICH & J. EHRENREICH, *THE AMERICAN HEALTH EMPIRE: POWER, PROFITS, AND POLITICS* 30 (1970).

30. *Id.* at 30-33.

31. Knowles, *The Hospital*, *SCIENTIFIC AM.*, Sept. 1973, at 128, 130-32. *See generally* S. REISER, *MEDICINE AND THE REIGN OF TECHNOLOGY* (1978).

32. Knowles, *supra* note 31, at 130.

33. S. LAW, *BLUE CROSS: WHAT WENT WRONG?* 6-11 (2d ed. 1976); H. SOMERS & A. SOMERS, *DOCTORS, PATIENTS, AND HEALTH INSURANCE* 252 (1961).

34. HEALTH INSURANCE INSTITUTE, *SOURCE BOOK OF HEALTH INSURANCE DATA 1977-78*, at 8, 23 (1978).

only inpatient services,³⁵ accelerated the displacement of the solo practitioner and, along with Hill-Burton construction funds,³⁶ provided a solid financial base for hospital expansion.³⁷ The enactment of Medicare³⁸ and Medicaid³⁹ in 1965 fueled a second round of growth and consolidated the dominance of the larger hospitals.⁴⁰

Statistics reflect the hospital industry's ascendancy in the health care sector. In 1929 expenditures for hospital care⁴¹ comprised 19.2% of all national expenditures for health services and supplies. By 1977 the figure had risen to 42.6%. During the same period, the proportion of expenditures paid for physicians' services declined from 27.7% to 19.8%.⁴² Hospitals are also consuming an increasing proportion of government spending for health care. Their share of public expenditures climbed from 48.4% in 1965 to 57.8% in 1977.⁴³

Expenditures for health services only partially reflect the modern hospital's preeminence. While the hospital's primary function is still the provision of personal medical care, its role has become much broader. Most medical students, interns, and residents, as well as many other health professionals, are trained exclusively in hospitals.⁴⁴ The

35. *Id.* at 21; see H. SOMERS & A. SOMERS, *supra* note 33, at 250 (explanation of enrollment categories).

36. See text accompanying notes 160-66 *infra*.

37. The number of community hospitals grew from 4444 in 1946 to 5736 in 1965, and bed supply increased from 473,000 to 741,000. AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS: 1978, at 5 (Table 1) (1978). For a definition of "community hospital," see text accompanying note 49 *infra*.

38. Social Security Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286 (1965) (codified in scattered sections of 26, 42, 45 U.S.C.). For an early appraisal of the legislation's impact, see H. SOMERS & A. SOMERS, MEDICARE AND THE HOSPITALS (1967).

39. Social Security Amendments of 1965, Pub. L. No. 89-97, §§ 1901-05, 79 Stat. 343 (1965) (codified at 42 U.S.C. § 1396 (1976)). For a good early analysis, see Stevens & Stevens, *Medicaid: Anatomy of a Dilemma*, 35 LAW & CONTEMP. PROB. 348 (1970).

40. B. EHRENREICH & J. EHRENREICH, *supra* note 29, at 37-39.

Although the number of community hospitals has grown only slightly since 1965, the number of beds has increased by 31%. Small hospitals have experienced an absolute and relative decline. The number of community hospitals with less than 100 beds dropped from 3489 in 1965 to 2833 in 1977. During the same period the number with more than 400 beds increased from 292 to 554. These large institutions accounted for about one-fourth (25.2%) of all community hospital beds in 1965 compared to about one-third (33.2%) in 1977. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at vii-viii (Text Table 5, Text Table 6) (1977 figures); AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS: 1977, at vii-viii (Text Table 3, Text Table 4) (1977) (1965 figures).

41. "Hospital care" expenditures cover all spending for both inpatient and outpatient care, including all services by hospital staff (including physicians salaried by the hospital) and the purchase of drugs and other supplies. Self-employed physicians' services in hospitals (those of surgeons, for example) are not included. Gibson & Fisher, *supra* note 4, at 17-18.

42. See *id.* at 15 (Table 5).

43. See *id.* at 11 (Table 4) (1977 figures); Hanft, *National Health Expenditures, 1950-65*, Soc. SEC. BULL., Feb. 1967, at 3, 4 (1965 figures).

44. For a critique of the close relationship between the teaching hospital and the medical

hospital is also the site of continuing medical education programs.⁴⁵ At the major medical centers a large portion of institutional resources are devoted to medical research.⁴⁶ Finally, some hospitals have attempted to extend their reach into the community by establishing satellite health centers and programs of community health education.⁴⁷ While not all these services are produced solely by the hospital, the hospital is unique in that "there exist no services which are not produced within, or under its institutional aegis."⁴⁸

1. Variation Among Hospitals

The hospital industry is composed of an enormous variety of institutions. The long-term psychiatric hospital and the college infirmary, the decaying municipal institution and the suburban proprietary facility, the huge medical school complex and the fifty-bed rural outpost: all share a common label. In an effort to define the most important part of the industry more specifically, the American Hospital Association has developed a hybrid descriptor, the "community hospital." Although the term excludes long-term and federal hospitals, as well as hospital units of institutions such as prisons and college infirmaries,⁴⁹ it still encompasses more than 80% of all hospitals⁵⁰ and tends to mask important differences among them. The usefulness of the definition is thus limited by its breadth.

From 1967 to 1977, the average number of beds per community hospital increased from 135 to 165.⁵¹ Yet the industry continues to be characterized by small institutions. In 1977 close to one-half of all community hospitals had less than 100 beds.⁵² Yet most health economists believe that substantial economies of scale are associated with larger hospital size, at least up to about 200 beds.⁵³ From the

school, see Ebert, *Medical Education in the United States*, in *DOING BETTER AND FEELING WORSE* 171 (J. Knowles ed. 1977).

45. See Gaintner, *Continuing Medical Education in the Community Hospital*, 51 BULL. N.Y. ACAD. MED. 739 (1975); Stearns, *Positive Approaches to Continuing Medical Education in Community Hospitals*, 277 NEW ENGLAND J. MED. 1341 (1967).

46. Glaser, *The Teaching Hospital and the Medical School*, in *THE TEACHING HOSPITAL* 7, 27 (J. Knowles ed. 1966).

47. Knowles, *supra* note 31, at 136.

48. S. BERKL, *HOSPITAL ECONOMICS*, at xviii (1972).

49. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at xxii.

50. *Id.* at 4, 7 (Table 1).

51. *Id.* at vii.

52. *Id.* This group is gradually shrinking. See note 40 *supra*.

53. See, e.g., V. FUCHS, *WHO SHALL LIVE? HEALTH ECONOMICS AND SOCIAL CHANGE* 82 (1974).

standpoint of economic efficiency, it seems impossible to justify the continued existence of so many small hospitals.⁵⁴

At the opposite end of the spectrum from the small, typically rural, hospital lies the "teaching hospital," site of undergraduate and graduate training for physicians.⁵⁵ While only comprising 13.1% of all community hospitals, teaching hospitals account for a disproportionate, and increasing, share of beds, admissions and outpatient visits.⁵⁶ Drawing prestige and resources from the medical schools with which they are affiliated, teaching hospitals exert a large influence on the rest of the hospital industry.⁵⁷

Seventy percent of community hospitals are privately owned.⁵⁸ In accord with the hospital's religious and philanthropic origins, more than four-fifths of these private institutions are operated on a nonprofit basis.⁵⁹ Investor-owned, for-profit institutions constitute a small, but growing portion of the industry.⁶⁰ The rapid expansion of proprietary hospital chains in the 1970s has inspired considerable controversy. Some see proprietaries as a source of healthy competition; others perceive a grave threat to the hospital's community service mission.⁶¹

The remaining community hospitals are owned and operated by state and local governments. Many urban public hospitals are beset with serious financial difficulties. Serving a large proportion of indigent patients, inadequately reimbursed by third-party payors, and

54. *Id.* at 82-84. This is particularly true of hospitals in urban areas. Fuchs estimates that in 1973 there were more than 1000 metropolitan hospitals with less than 200 beds. *Id.*

55. See Enright & Jonas, *supra* note 27, at 168, 170.

56. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 20 (Table 5A), 186 (Table 10A). In 1977 community hospitals affiliated with medical schools accounted for 35.0% of community hospital beds, 34.3% of admissions, and 45.7% of outpatient visits. The average affiliated hospital had 439 beds, compared with 123 for nonaffiliated hospitals. *Id.* at 180 (Table 8), 20 (Table 5A). For a view of the rapid rate of growth of teaching hospitals compare these figures to 1972 data. AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS: 1972, at 34, 190 (Table 5, Table 9) (1973).

57. See generally Glaser, *supra* note 46.

58. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 20 (Table 5A).

59. *Id.* On voluntary hospitals generally, see A. SOMERS, *supra* note 2.

60. Between 1972 and 1977, the share of community hospital beds held by proprietary hospitals increased from 6.5% to 8.3%. See AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 20 (Table 5A) (1977 figures); AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS: 1972, at 4 (Table 5) (1973) (1972 figures).

61. For a good early discussion of the issues, see Steinwald & Neuhauser, *The Role of the Proprietary Hospital*, 35 LAW & CONTEMP. PROB. 817 (1970). For an early critical view, see A. SOMERS, *supra* note 2, at 198-200. Proprietary hospital chains have been the subject of several recent journalistic reports. See, e.g., Miller, *Dying for Dollars*, 6 SOUTHERN EXPOSURE, Feb. 1978, at 105, 107-09; Shabecoff, (N.Y. Times News Service), *For-Profit Hospitals Growing Fast Despite Public, Medical Criticism*, News and Observer (Raleigh, N.C.), Sept. 17, 1978, at 1, col. 4; Shabecoff (N.Y. Times News Service), *Private Hospital Chain Is Proving Successful*, News and Observer (Raleigh, N.C.), Sept. 18, 1978, at 10, col. 1.

victims of municipal fiscal crises, they are engaged in a constant struggle for survival.⁶² Surprisingly, the great majority of public hospitals are rural; in their clientele, staffing and financial position, they do not differ significantly from other rural community hospitals.⁶³

Hospital characteristics vary significantly by region. As one might expect, hospitals are largest in the urban Middle Atlantic States and smallest in the predominantly rural Mountain States.⁶⁴ Proprietary hospitals are concentrated in the Pacific and Southern regions; they are of only negligible importance in the New England and North Central States.⁶⁵ Public institutions account for about one-third of community hospital beds in the Southern States; in the Northeast, the figure is only about 10%.⁶⁶

In recent years per capita hospital expenditures in the Northeast have exceeded those in the South by 50% and those in the West by 30%.⁶⁷ Differences in labor costs account for most of the disparity between the Northeast and the South, but cannot explain the Northeast-West differential. Hospital utilization appears to be the critical distinguishing factor: the entire gap in per capita expenditures between Northeast and West can be traced to the difference in length of stay.⁶⁸ A person admitted to a community hospital in the State of Washington can expect to be out in 5.5 days, but his or her cousin in New York can look forward to a stay of 9.8 days.⁶⁹ Only a small part of the gap is caused by differences in age composition of the population: at given

62. HOSPITAL RESEARCH AND EDUCATIONAL TRUST, *THE FUTURE OF THE PUBLIC-GENERAL HOSPITAL* 6-7 (1978). For a guardedly optimistic view, see Craig & Koleda, *The Urban Fiscal Crisis in the United States, National Health Insurance, and Municipal Hospitals*, 8 INT'L J. HEALTH SERVICES 329 (1978). See generally Dumbaugh, Bentkover & Newhauser, *Public Hospitals: An Evaluation*, in HEALTH SERVICES: THE LOCAL PERSPECTIVE 148 (A. Levin ed. 1977).

63. HOSPITAL RESEARCH AND EDUCATIONAL TRUST, *supra* note 62, at 7-8. See generally M. ROEMER, *RURAL HEALTH CARE* 77-79 (1976).

64. See AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 22-39 (Table 5B). In 1977 community hospitals in the Mountain States averaged 107 beds; the average in the Middle Atlantic States was 260.

65. *Id.* At the upper extreme, 18.7% of community hospital beds in the West South Central States were in proprietary institutions in 1977. The comparable figure was only 0.6% in the East North Central States.

66. *Id.* In the subregions, the range was from 38% (East South Central) to 5.3% (New England). *Id.*

67. V. FUCHS, *supra* note 53, at 89. In 1977 per capita community hospital expenditures in the Northeast were 39.3% higher than in the South and 21.6% higher than in the West. Thus the gap has narrowed since Fuchs wrote in 1974. These figures are derived from AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 152-71 (Table 6), and 1977 population estimates by the Census Bureau, BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, *STATISTICAL ABSTRACT OF THE UNITED STATES* 14 (1978).

68. V. FUCHS, *supra* note 53, at 89.

69. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 104, 134 (Table 5C).

ages and for given diagnoses, stays are significantly shorter in the West.⁷⁰ The regional variations in length of stay, without any associated difference in health outcomes, suggest that hospital services are frequently overutilized.⁷¹

2. Rise in Hospital Costs

Hospitals are an extraordinarily diverse breed. One characteristic, however, seems common to all: costs are rising at an alarming rate. In 1950 Americans spent \$3.7 billion for hospital care or about \$24 per capita. In 1977 the aggregate reached \$65.6 billion and per capita expenditures climbed to \$297.⁷² During this twenty-eight year period, expenditures for hospital care grew more than two and one half times as fast as the Gross National Product.⁷³ Since 1965, the annual rate of increase has averaged a staggering 14.3%.⁷⁴

A small but significant portion of the increase in per capita expenditures can be attributed to increased rates of hospital use.⁷⁵ A much greater part—close to ninety percent—is the result of the rise in the average daily cost of hospital care.⁷⁶ The average cost per patient day in community hospitals increased from \$15.62 in 1950 to \$48.15 in

70. V. FUCHS, *supra* note 53, at 89.

71. For a discussion of the forces that encourage overutilization, see notes 81-92, 103 and accompanying text *infra*.

It is not clear why the average length of stay is so much shorter in the West. It cannot be said that overutilization has been discouraged by more rational capital investment; community hospitals in the Pacific States have the lowest occupancy rate in the nation. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at 22-39 (Table 5B). A more plausible explanation is the prevalence of prepaid group practices. Physicians working for health maintenance organizations (HMOs), in contrast with fee-for-service practitioners, have every incentive to make a patient's hospital stay as expeditious as possible. See generally Havighurst, *Health Maintenance Organizations and the Market for Health Services*, 35 LAW & CONTEMP. PROB. 716, 720-22 (1970). For a discussion of data comparing hospital utilization among matched HMO and fee-for-service populations, see W. MCCLURE, REDUCING EXCESS HOSPITAL CAPACITY 22-23 (DHEW Pub. No. HRP-0015199, Oct. 1976).

72. See Gibson & Fisher, *supra* note 4, at 6 (Table 2), 15 (Table 5).

73. See *id.* at 14 (Chart 2), 15 (Table 5).

74. See *id.* at 15 (Table 5).

75. The number of patient-days in short-term hospitals rose from .855 per capita in 1950 to 1.21 per capita in 1975, an annual rate of increase of 1.2%. COUNCIL ON WAGE AND PRICE STABILITY, THE RAPID RISE OF HOSPITAL COSTS 4 & n.1 (Staff Report 1977) [hereinafter cited as THE RAPID RISE OF HOSPITAL COSTS].

76. *Id.* Two different measures of the daily cost of hospital care are commonly used: (1) the Bureau of Labor Statistics' Index of Hospital Service Charges (IHSC); and (2) the American Hospital Association's Average Cost Per Patient Day (ACPPD). The IHSC attempts to measure the changing price of a *fixed* bundle of common hospital services. The ACPPD, calculated by dividing total hospital operating expenses by the number of inpatient days of care provided, reflects the changing mix and volume of services as well as changes in the price of each type of service. The ACPPD is the more appropriate indicator of the total increase in hospital cost. *Id.* at 5-6.

1966 and \$175.08 in 1976.⁷⁷ Inflation in the general economy accounts for less than half of the increase. Measured in constant dollars, the average cost per day increased fivefold from 1950 to 1976.⁷⁸

While the seriousness of hospital cost inflation is generally acknowledged, little consensus exists on the underlying causes.⁷⁹ At least eight contributing factors are widely cited in the literature: (1) insurance coverage; (2) cost-based reimbursement; (3) excess capacity; (4) labor costs; (5) technological advances; (6) the expanding role of the community hospital; (7) physician control of demand; and (8) lack of competition among providers. The choice of an appropriate cost containment strategy largely depends on which inflationary factors are seen as most important—and which are most amenable to government intervention.

a. Insurance coverage

Evidence strongly suggests that increases in insurance coverage, coupled with rising incomes, have played a major part in hospital cost inflation.⁸⁰ Private insurance coverage grew rapidly from 1950 until the mid-1960s and then more moderately in the ensuing decade; public financing of hospital care has mushroomed since the advent of Medicare and Medicaid in 1966. As a result of these developments, consumers are now largely insulated from the cost of hospital care at the time of illness. In 1950, 50% of community hospital costs were covered by out-of-pocket patient payments. By 1975, the figure had dropped to 12% with public and private insurance splitting the remainder.⁸¹ While the average cost per patient day rose by a factor of ten from 1950 to

77. See *id.* at 7 (Table 1). These figures include outpatient costs and thus overstate the cost of an inpatient day. An adjusted index, developed by the AHA in 1963, excludes outpatient costs and is about 12% lower than the unadjusted index. The less sensitive indicator has been used in order to allow pre-1963 comparisons. The two indices have risen at very similar rates since 1963. *Id.* at 5 n.2.

78. See *id.* at 8.

79. For discussions of different theories of hospital cost inflation, see OFFICE OF RESEARCH AND STATISTICS, SOCIAL SECURITY ADMINISTRATION, REPORT NO. 41, COMMUNITY HOSPITALS: INFLATION IN THE PRE-MEDICARE PERIOD (1972) [hereinafter cited as COMMUNITY HOSPITALS]; Davis, *Rising Hospital Costs: Possible Causes and Cures*, 48 BULL. N.Y. ACAD. MED. 1354 (1972); McCarthy, *Supply and Demand and Hospital Cost Inflation*, 33 MED. CARE REV. 923 (1976).

80. See THE RAPID RISE OF HOSPITAL COSTS, *supra* note 75, at 29-38; M. FELDSTEIN, THE RISING COST OF HEALTH CARE (1971). Feldstein's views have been corroborated by other researchers. McCarthy, *supra* note 79, at 940-44. See, e.g., Davis, *Hospital Costs and the Medicare Program*, SOC. SEC. BULL., Aug. 1973, at 18. See also COUNCIL ON WAGE AND PRICE STABILITY, THE COMPLEX PUZZLE OF RISING HEALTH CARE COSTS: CAN THE PRIVATE SECTOR FIT IT TOGETHER? 83-88 (1976) [hereinafter cited as THE COMPLEX PUZZLE].

81. THE RAPID RISE OF HOSPITAL COSTS, *supra* note 75, at 31 (Table 8).

1975, the out-of-pocket cost of care, excluding third-party payments, experienced a much more modest increase. Relative to the cost of all other goods and services, the overall net cost of hospital care to the consumer has remained virtually unchanged since 1950.⁸² With constant out-of-pocket costs, and increasing disposable income, patients demand more services and higher quality care. As explained in a recent staff report of the Council on Wage and Price Stability, "Hospitals respond by raising their cost per patient day and using the extra revenue to provide a more expensive style of care. This change in the apparent quality of care further increases demand, setting off another round of price and quality increases."⁸³ In order to protect themselves from the increasing costs of hospitalization, consumers purchase more insurance, refueling the cycle.

b. Cost-based reimbursement

Instead of focusing on the extensiveness of third-party coverage, some economists have stressed the nature of third-party reimbursement. Many public and private health insurance plans, covering a large majority of hospital services, reimburse institutional providers on the basis of costs.⁸⁴ The inflationary impact is obvious; since increased costs are simply passed on to third-party payors, hospitals have little incentive to restrain capital expenditures or to operate efficiently.⁸⁵

c. Excess capacity

It has now become clear that excessive investment in hospital equipment and facilities is a major inflationary factor.⁸⁶ Trustees, physicians and administrators, particularly in nonprofit institutions, are

82. *See id.* at 33-34.

83. *Id.* at 36 (footnote omitted).

84. Klarman, *Approaches to Moderating the Increases in Medical Care Costs*, 7 MED. CARE 175, 185 (1969). Cost-based reimbursement was already widespread before Medicare: services for more than three-fourths of Blue Cross enrollees were reimbursed at cost. Yet cost-based reimbursement was not the dominant mode until Medicare increased the number of patient days reimbursed at cost by more than 75%. *Id.* *See also* THE COMPLEX PUZZLE, *supra* note 80, at 11-13, 86.

85. Empirical studies that have tested the cost-reimbursement hypothesis are evaluated in McCarthy, *supra* note 79, at 933-35.

For an excellent analysis of the failure of private insurers to restrain costs, see Havighurst, *Controlling Health Care Costs: Strengthening the Private Sector's Hand*, 1 J. HEALTH POL. POL'Y & L. 471, 474-82 (1977). The intimate ties between the hospital industry and Blue Cross are analyzed in S. LAW, *supra* note 33.

86. *See* W. McCURE, *supra* note 71. *See also* B. ENSMINGER, THE \$8 BILLION HOSPITAL BED OVERRUN (1975); INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES, CONTROLLING THE SUPPLY OF HOSPITAL BEDS (1976); Havighurst, *Regulation of Health Facilities and Services by "Certificate of Need,"* 59 VA. L. REV. 1143, 1156-59 (1973).

often more interested in prestigious additions than inexpensive patient care.⁸⁷ Unwarranted expansion of hospital bed capacity and unnecessary equipment purchases result in higher fixed costs, which are eventually borne by consumers in the form of increased service charges and insurance premiums.⁸⁸

Given current rates of hospital use, it is estimated that 5 to 10% of the existing beds could be eliminated with no adverse effects on health.⁸⁹ Moreover, considerable evidence indicates that present rates of use are excessive. Great international, regional and small area variations in per capita rates of hospital use cannot be explained by any known health risk factors and are not associated with any ascertainable differences in health outcomes.⁹⁰ As Roemer and Shain first demonstrated, excess capacity itself appears to induce overutilization.⁹¹ Physicians, paid on a fee-for-service basis, and hospital administrators, conscious of high fixed costs, share a common interest in keeping beds filled.⁹²

d. Labor costs

Other students of hospital cost inflation have emphasized the rapid increase in labor costs. Since 1955, hospital wages have risen faster than earnings in other parts of the economy.⁹³ Part of the differential in the rate of increase in the early years may reflect a "catching up" of wages for workers who have traditionally been underpaid.⁹⁴ Unionization, a tight labor market in the mid-1960s and a change in the skill-mix of hospital employees have also been cited as explanatory

87. Bovbjerg, *Problems and Prospects for Health Planning: The Importance of Incentives, Standards, and Procedures in Certificate of Need*, 1978 UTAH L. REV. 83, 85; Havighurst, *supra* note 86, at 1160-63. See generally B. ENSMINGER, *supra* note 86, at 42-43.

88. See Havighurst, *supra* note 86, at 1157.

89. W. MCCLURE, *supra* note 71, at 19-20.

90. *Id.* at 22-27.

91. Shain & Roemer, *Hospital Costs Relate to the Supply of Beds*, MOD. HOSPITAL, April 1959, at 71. See Klarman, *supra* note 84, at 177-79. McClure offers a rough estimate of the strength of the relationship: holding other factors constant, a 10% increase in beds per 1000 persons is associated with a 4% rise in patient days per 1000 persons. W. MCCLURE, *supra* note 71, at 15.

92. Bovbjerg, *supra* note 87, at 87; Havighurst, *supra* note 86, at 1158.

93. THE RAPID RISE OF HOSPITAL COSTS, *supra* note 75, at 13.

94. *Id.* at 56-57. According to a 1977 staff report of the Council on Wage and Price Stability, hospital workers achieved parity with employees in the same occupations in other industries by the early 1970s. Since then, however, hospital wages have continued to rise more rapidly than wages in other industries. *Id.* at 39-63. The report identified the rise in hospital employment, the use of "relative wage scales," the role of hospital unions and "philanthropic wage setting" as possible inflationary factors. *Id.* at 62, 64-65.

factors.⁹⁵ Regardless of the reason for the rapid rate of increase in wages, its impact on hospital cost inflation is relatively insignificant, accounting for only about one-fourth of the increase of hospital costs in excess of the general rise in consumer prices.⁹⁶ Moreover, labor costs have not increased as fast as expenditures for other inputs. The payroll component of the community hospital budget has declined from 62% in 1965 to 51% in 1977.⁹⁷

e. Technological advances

There is no doubt that increasingly sophisticated medical technology has raised the cost of hospital care. CT scanners, intensive care units, kidney dialysis facilities, heart-lung machines and other expensive diagnostic and therapeutic modalities have proliferated with astonishing rapidity.⁹⁸ Even if the enormous capital and operating costs simply represent the price we must pay for modern high-quality care, the duplication of expensive, underutilized facilities in neighboring hospitals cannot be justified.⁹⁹

f. The expanding role of community hospitals

Part of the rise in hospital expenditures can be attributed to the expanded scope of hospital services.¹⁰⁰ Community hospitals have assumed some of the roles traditionally filled by other providers. For example, hospital emergency rooms become increasingly important as private physicians restrict their practices to daytime office visits. Similarly, the growth of psychiatric inpatient and outpatient services in short-term hospitals is associated with the decline of mental hospitals.¹⁰¹

95. Davis, *supra* note 79, at 1357 (citing, but not endorsing, these explanations). Elsewhere, Davis does suggest that there was a slight shift toward more highly skilled personnel from 1960 to 1966. COMMUNITY HOSPITALS, *supra* note 79, at 31. *But see* THE RAPID RISE OF HOSPITAL COSTS, *supra* note 75, at 43-46 (evidence of a decline in the skill-mix).

96. THE RAPID RISE OF HOSPITAL COSTS, *supra* note 75, at 13.

97. AMERICAN HOSPITAL ASSOCIATION, *supra* note 37, at x (Text Table 11) (1977 figures); AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS: 1977, at xiii (1965 figures).

98. *See* Banta & Sanes, *How the CAT Got Out of the Bag*, in TECHNOLOGY AND THE QUALITY OF HEALTH CARE 175 (R. Egdahl & P. Gertman eds. 1978) (CT scanner phenomenon); Knowles, *supra* note 31.

99. *See* THE COMPLEX PUZZLE, *supra* note 80, at 9, 87-88; W. McClure, *supra* note 71, at 21.

100. *See, e.g.*, Davis, *supra* note 79, at 1364-65 (noting increase in use of hospital outpatient services).

101. *Id.* at 1359.

g. *Physician control of demand*

The physician-patient relationship is characterized by a gross disparity in power and knowledge.¹⁰² The control exercised by the physician contributes to the escalation of health care costs in general, and hospital costs in particular. Consumers of health services are unable to make informed, independent decisions based on price and quality. The choice of hospitalization and hospital, laboratory tests, prescription drugs, surgical procedures and length of stay remain in the physician's hands. The patient rarely dares to question decisions made on his behalf. It is widely suspected that physician-directed demand results in excessive use of services.¹⁰³ At the least, it results in use that is insensitive to price.

h. *Lack of competition among providers*

Patients in rural areas have little choice of hospitals or physicians.¹⁰⁴ Even in large cities, a patient is typically restricted to the institutions where his or her physician has staff privileges.¹⁰⁵ Limitations on advertising, enforced by medical societies and sometimes by state law, inhibit the patient's choice of physician.¹⁰⁶ Furthermore, physicians exercise monopoly power by limiting entry into the profession¹⁰⁷ and controlling the delegation of tasks to other health workers.¹⁰⁸ Cost-effective innovations in the delivery and financing of

102. McCarthy, *Financing for Health Care*, in HEALTH CARE DELIVERY IN THE UNITED STATES 247, 275 (S. Jonas ed. 1977). See also THE COMPLEX PUZZLE, *supra* note 80, at 85-86; see generally E. FREIDSON, PROFESSIONAL DOMINANCE: THE SOCIAL STRUCTURE OF MEDICAL CARE (1974).

103. See, e.g., Evans, *Supplier-Induced Demand: Some Empirical Evidence and Implications*, in THE ECONOMICS OF HEALTH AND MEDICAL CARE 162 (M. Perlman ed. 1975); Fuchs, *The Supply of Surgeons and the Demand for Operations*, 13 Supp. J. HUMAN RESOURCES 35 (1978); Havighurst, *supra* note 86, at 479-81.

104. See M. ROEMER, *supra* note 63, at 73-79; Cordes, *Distribution of Physician Manpower*, in RURAL HEALTH SERVICES: ORGANIZATION, DELIVERY, AND USE 56 (E. Hassinger & L. Whiting eds. 1976).

105. See generally Ludlam, *Physician-Hospital Relations: The Role of Staff Privileges*, 35 LAW & CONTEMP. PROB. 879 (1970).

106. THE COMPLEX PUZZLE, *supra* note 80, at 87; see Canby & Gellhorn, *Physician Advertising: The First Amendment and the Sherman Act*, 1978 DUKE L.J. 543; Grad, *The Antitrust Laws and Professional Discipline in Medicine*, 1978 DUKE L.J. 443, 457-68.

107. See Kessel, *The A.M.A. and the Supply of Physicians*, 35 LAW & CONTEMP. PROB. 267 (1970). For an interesting historical and sociological analysis, see J. BERLANT, PROFESSION AND MONOPOLY: A STUDY OF MEDICINE IN THE UNITED STATES AND GREAT BRITAIN (1975).

108. Physician's assistants and nurse practitioners have only achieved a carefully circumscribed form of independence. See generally THE NEW HEALTH PROFESSIONALS (A. Bliss & E. Cohen eds. 1977).

services have been stymied by organized provider opposition.¹⁰⁹

Each of the factors mentioned above offers a partial explanation of the rapid rise in hospital costs. The cumulative effect is powerful indeed. Given the complexity of the phenomenon, it is hardly surprising that the proposals for governmental action have been so varied and at times contradictory. Nor is it surprising that hospital cost inflation has so far remained impervious to tentative regulatory initiatives.

B. Nursing Homes

1. Growth of Nursing Home Industry

While students of health care regulation have appropriately focused on the hospital, it is unfortunate that they have given so little attention to the nursing home. Fueled by Medicare and Medicaid, the nursing home industry has grown spectacularly since the mid-1960s. It continues to be the most dynamic part of the burgeoning health care sector.¹¹⁰ Once typified by the independent "Mom and Pop" operation, the industry is now the domain of the investor-owned proprietary chain. With change has come increasing controversy. Sensational revelations about abuses of patients¹¹¹ and finances,¹¹² and bitter struggles between health planners and nursing home entrepreneurs,¹¹³ have become staple features of the industry.

Specialized institutions to provide care for the elderly are of

109. See Havighurst, *Professional Restraints on Innovation in Health Care Financing*, 1978 DUKE L.J. 304, 306-19. See also Havighurst, *supra* note 86, at 1204-15; Kissam, *Health Maintenance Organizations and the Role of Antitrust Law*, 1978 DUKE L.J. 487.

110. In 1977, expenditures for nursing home care rose 16.5%. Hospitals were the second most inflationary category in the health care industry; expenditures for hospital care increased by 14.1%. See Gibson & Fisher, *supra* note 4, at 7 (Table 3), 8 (Table 3). See also Butler, *Assuring the Quality of Care and Life in Nursing Homes: The Dilemma of Enforcement*, this Symposium.

111. See, e.g., F. MOSS & V. HALAMANDARIS, *TOO OLD, TOO SICK, TOO BAD: NURSING HOMES IN AMERICA* 15-37, 306 n.1 (1977).

112. See, e.g., *id.* at 73-102; M. MENDELSON, *TENDER LOVING GREED* (1974).

113. Nursing homes initiated four of the five constitutional challenges to state certificate of need laws. *Goodin v. Oklahoma ex rel. Okla. Welfare Comm'n*, 436 F. Supp. 583 (W.D. Okla. 1977); *Simon v. Cameron*, 337 F. Supp. 1380 (C.D. Cal. 1970); *Merry Heart Nursing & Convalescent Home, Inc. v. Dougherty*, 131 N.J. Super. 412, 330 A.2d 370 (1974); *Attoma v. State Dep't of Social Welfare*, 26 A.D.2d 12, 270 N.Y.S.2d 167 (1966). The only successful constitutional challenge was made by a hospital. *In re Certificate of Need for Aston Park Hosp., Inc.*, 282 N.C. 542, 193 S.E.2d 729 (1973).

Nursing homes have consistently had more difficulty than hospitals in winning approval for their capital expansion projects. See studies cited in D. Cohodes, C. Cerf & J. Cromwell, *A Review and Analysis of the Research Literature on State Certificate of Need Programs* 28 (June 1978) (draft prepared for Bureau of Health Planning and Resources Development, Health Resources Administration, Dep't of Health, Education and Welfare).

relatively recent origin.¹¹⁴ The extended family traditionally provided custodial and health care to the aged and infirm; those without family or resources were relegated to the public almshouse.¹¹⁵ The Depression vastly increased the number of elderly persons in need of assistance. Congress responded by passing the Social Security Act of 1935.¹¹⁶ The Act provided financial aid to the elderly, but excluded inmates of public institutions.¹¹⁷ The result, apparently unforeseen by those who drafted the legislation,¹¹⁸ was the dramatic and largely unregulated growth of the proprietary nursing home sector.¹¹⁹

In 1966, the infusion of funds from Medicare and Medicaid set off a second era of explosive growth. A few indicators suggest the dimensions of the phenomenon:

- (1) In 1965, expenditures for nursing home care totaled \$1.3 billion, or 3.3% of all health expenditures. In 1977, expenditures had increased almost *ten* times to \$12.6 billion, and constituted 7.8% of all health spending.¹²⁰
- (2) Nursing homes are absorbing an increasing proportion of health care expenditures made by the elderly; in 1966 15% of the money spent for health care by persons aged 65 and older went to nursing homes; by 1976 the figure had jumped to 23%.¹²¹
- (3) Between 1963 and 1977, the number of nursing home beds and residents increased two and one-half times.¹²²

With the elderly population continuing to grow at a rapid rate during

114. Levey & Amidon, *The Evolution of Extended Care Facilities*, 16 NURSING HOMES 14 (1967).

115. *Id.* at 16-17. See also W. THOMAS, NURSING HOMES AND PUBLIC POLICY: DRIFT AND DECISION IN NEW YORK STATE 20-29 (1969).

116. Ch. 531, 49 Stat. 620 (1935) (codified in scattered sections of 42 U.S.C.).

117. *Id.* § 3(a); see W. THOMAS, *supra* note 115, at 49.

118. See W. THOMAS, *supra* note 115, at 45 (interview with draftsman of New York Old Age Security Act of 1930). Early New York legislation served as the model for the Social Security Act of 1935. *Id.* at 50-51.

119. See *id.* at 57-58 (New York experience).

120. Gibson & Fisher, *supra* note 4, at 15 (Table 5).

121. NATIONAL CENTER FOR HEALTH STATISTICS, HEALTH, UNITED STATES, 1976-77, at 20-22 (1977) (DHEW Pub. No. HRA 77-1232) (Table E) [hereinafter cited as HEALTH].

122. NATIONAL CENTER FOR HEALTH STATISTICS, ADVANCEDATA FROM VITAL AND HEALTH STATISTICS, AN OVERVIEW OF NURSING HOME CHARACTERISTICS: PROVISIONAL DATA FROM THE 1977 NATIONAL NURSING HOME SURVEY 2 (Table 1) (1978) [hereinafter cited as ADVANCEDATA]; National Center for Health Statistics, *Utilization of Institutions for the Aged and Chronically Ill, United States, April-June, 1963*, 12:21 VITAL AND HEALTH STATISTICS 14, 21 (1966) (DHEW Pub. No. HRA 74-1706) (Table 1, Table 6) ("hospital care" data excluded from the total).

the coming decades,¹²³ further expansion of the industry is inevitable.

2. Variation Among Nursing Homes

Like hospitals, nursing homes exhibit considerable diversity. Nursing homes can be distinguished by the services they provide. *Skilled nursing facilities* are intended primarily for people requiring twenty-four hour nursing services. *Intermediate care facilities* offer less intensive nursing care.

Medicare covers services received in skilled nursing facilities for a limited period of time following a spell of illness;¹²⁴ similarly, Medicaid programs must cover services in skilled nursing facilities.¹²⁵ In addition, states have the option of offering Medicaid coverage for services in intermediate care facilities;¹²⁶ approximately one-third of the states currently do so.¹²⁷ A declining, but still significant number of homes are not certified by either Medicaid or Medicare. In 1977, 12.4% of nursing home beds fell into this category.¹²⁸

The nursing home industry is dominated by proprietary institutions. Of the homes represented in a survey conducted by the National Center for Health Services in 1977, only 26% were nonprofit or public institutions.¹²⁹ Most nursing homes are small. In 1977, 71% of all homes had less than 100 beds.¹³⁰

Differences in Medicaid coverage and eligibility requirements¹³¹ have caused interstate variations in nursing home use to be far more significant than regional variations. In 1973, there were at least 60 nursing home residents per 1000 elderly persons in 13 states; in 8 states there were fewer than 30.¹³² The state with the highest proportion of the elderly population in nursing homes was Minnesota (8.2%); the lowest was West Virginia (1.6%).¹³³

123. COMMISSION ON POPULATION GROWTH, POPULATION AND THE AMERICAN FUTURE 97-98 (1972).

124. See Butler, this Symposium, at text accompanying notes 18-25.

125. *Id.*

126. *Id.*

127. ADVANCEDATA, *supra* note 122, at 2 (Table 1).

128. *Id.*

129. *Id.*

130. *Id.*

131. See Butler, this Symposium, at text accompanying notes 18-25.

132. HEALTH, *supra* note 121, at 336-37 (Table 134).

133. *Id.* at 19.

3. Reimbursement Policies

State Medicaid reimbursement policies are of critical importance to the industry. In 1977 Medicaid paid for 51% of nursing home expenditures.¹³⁴ It is estimated that between 60 and 70% of nursing home patients have either partial or total Medicaid coverage.¹³⁵ Since reimbursement policies have a direct effect on profits, capital investment and quality of care, they have been the focus of intense lobbying efforts by the nursing home industry.¹³⁶

While Medicaid fostered the growth of the industry in the 1960s by vastly increasing effective demand,¹³⁷ its current impact is more ambivalent. State governments, as primary purchasers of nursing home services, have sometimes acted aggressively to limit cost increases by adjusting their Medicaid reimbursement policies and eligibility requirements.¹³⁸ The contrast with hospitals is instructive. With few exceptions, third-party payors have exercised little effective control over hospital costs.¹³⁹

The kind of incentives that encourage overutilization of physician and hospital services are largely absent in the nursing home industry. The nursing home operator has little direct influence on the demand for services.¹⁴⁰ Most physicians are not interested in increasing nursing home use since they characteristically relinquish responsibility for care when the patient enters the home.¹⁴¹ Allegations of financial ties between nursing homes and referring physicians are largely undocumented.¹⁴² When compared to those who use hospital services, the nursing home consumer is relatively more sensitive to the price of services. Almost all of the 40% of nursing home expenditures that come

134. Gibson & Fisher, *supra* note 4, at 7 (Table 3). Medicare accounted for only 3% of nursing home expenditures in 1977. *Id.*

135. See B. Spitz, Nursing Homes and Prospective Reimbursement 3, 5 (Nov. 1976) (Urban Institute Working Paper 5057-2).

136. See *id.* at 4-7, 33-34.

137. See *id.* at 3.

138. See W. Scanlon, A Theory of the Nursing Homes Market 1 (Apr. 1978) (Urban Institute Working Paper 5057-1A). Cf. B. Spitz, *supra* note 135, at 18-36 (case study of struggle over Medicaid reimbursement rates in Michigan; emphasis on political power of the nursing home industry).

139. See McCarthy, *supra* note 79.

140. Of course, the state trade association can have a considerable indirect impact on demand by negotiating a favorable reimbursement rate. See B. Spitz, *supra* note 135, at 4-6.

141. See W. Scanlon, *supra* note 138, at 6.

142. Scanlon implies that such ties are rare. See *id.* at 6-7. Yet the hypothesis is unsupported. It is undoubtedly true that "the vast majority of physicians probably do not have a substantial financial interest in nursing homes." *Id.* at 7. But this tells us nothing about the proportions of nursing homes that have financial ties with physicians. More research is clearly needed.

from private funds were paid directly out of patient or family resources; private insurance coverage was negligible.¹⁴³ Moreover, in contrast with consumers of hospital services, many prospective nursing home residents and their families are relatively more able to make informed decisions about whether to seek care and where to obtain it, and to effectuate their choices independently.¹⁴⁴

Because of the differences between the economics of hospital services and those of nursing homes, it may be inappropriate to apply a regulatory scheme designed for hospitals to institutions that respond to very different incentives. For example, in states where there is no evidence of excess capacity or overutilization of nursing homes, it may be inappropriate to establish certificate of need controls over nursing homes.¹⁴⁵ Yet in the same states, regulatory efforts may well be needed to deal with the well-documented and practically universal problems of financial fraud and abuse¹⁴⁶ and the continuing difficulties of maintaining adequate quality of care.¹⁴⁷

II. GOVERNMENTAL CONTROLS ON HEALTH CARE

As the health care industry has changed, so has the nature of government involvement. When the cost of health care started its dramatic rise in the 1960s, both federal and state government reacted by changing their traditional "hands-off" posture and attempting to impose a variety of regulatory controls.

At least since the 1940s, most states have maintained licensure programs requiring hospitals and other health care institutions to meet minimum standards of quality and safety.¹⁴⁸ Traditionally these standards were directed only towards the condition of the facility itself (for example, the number of beds to a room, size and number of exits) and rarely imposed requirements affecting staffing patterns, admission practices or services delivered.¹⁴⁹ After the enactment of Medicaid and Medicare, federal law required health facilities to be certified for par-

143. Gibson & Fisher, *supra* note 4, at 7 (Table 3).

144. See W. Scanlon, *supra* note 138, at 4-6.

145. See W. Pollak, Medicaid Cost Containment Policy: Long-Term Care Reimbursement 39 & n.32 (rev. draft Apr. 1977) (Urban Institute Working Paper 986-11); Havighurst, *supra* note 86, at 1167-69.

146. See authorities cited note 112 *supra*.

147. See authorities cited note 111 *supra*.

148. See Worthingham & Silver, *supra* note 2, at 308. See also A. SOMERS, *supra* note 2, at 118-32.

149. Worthingham & Silver, *supra* note 2, at 308-09.

ticipation under conditions that were similar to, but somewhat broader than licensure standards.¹⁵⁰ In recent years certification requirements have become more rigorous,¹⁵¹ and some state licensing programs have been reoriented to have a more direct impact on service delivery.¹⁵²

There has also been an increasing governmental interest in utilization review. Concerned about the cost of services, but also about their quality and appropriateness, the federal government imposed limited utilization review requirements as conditions for participation in Medicaid and Medicare in the late 1960s.¹⁵³ Congress mandated more elaborate procedures in 1972 and authorized the creation of Professional Standards Review Organizations (PSROs) to review utilization by all Medicaid and Medicare providers.¹⁵⁴

The most serious efforts to regulate the health care industry, however, have been the establishment of programs to promote or, more recently, to require the planned distribution of health care resources. The concept remains controversial in theory and underdeveloped in practice.¹⁵⁵ Health planners are engaged in constant rearguard skirmishes with free market theorists and frustrating confrontations¹⁵⁶—or unseemly alliances¹⁵⁷—with powerful local interest groups. No one is happy with the result. Health planning efforts appear to have had only a marginal impact on the distribution of health

150. For a description of the certification standards as well as the process of enforcement, see Wing, *Title VI and Health Facilities: Forms Without Substance*, 30 HASTINGS L.J. 137, 163-68 (1978).

151. See Wing & Silton, this Symposium, at note 12.

152. See Butler, this Symposium, at text accompanying note 174.

153. For a summary of utilization review requirements under both Medicaid and Medicare, see Price, Katz & Provence, *An Advocate's Guide to Utilization Review*, 11 CLEARINGHOUSE REV. 307, 309-313.

154. Social Security Amendments of 1972, Pub. L. No. 92-603, §§ 1155-1170, 86 Stat. 1329 (codified as amended at 42 U.S.C.A. §§ 1320c to 1320c-22 (West 1974 & Cum. Supp. 1979)).

For a description of the PSRO program, see Price, Katz & Provence, *supra* note 153, at 318-27.

155. See, e.g., Havighurst, *supra* note 86, at 1153-54; Noll, *The Consequences of Public Utility Regulation of Hospitals*, in INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES, CONTROLS ON HEALTH CARE 25 (1975); Posner, *Certificates of Need for Health Care Facilities: A Dissenting View*, in REGULATING HEALTH FACILITIES CONSTRUCTION 113 (C. Havighurst ed. 1974). Cf. Correia, *Public Certification of Need for Health Facilities*, 65 AM. J. PUB. HEALTH 260 (1975); Grosse, *The Need for Health Planning*, in REGULATING HEALTH FACILITIES CONSTRUCTION 27 (C. Havighurst ed. 1974); Sheps and Madison, *The Medical Perspective*, in REGIONALIZATION AND HEALTH POLICY 15 (E. Ginzberg ed. 1977) (DHEW Pub. No. HRA 77-623) (advocating planned distribution of health care resources).

156. See, e.g., Havighurst, *supra* note 86, at 1148-51.

157. See, for example, the allegations in *Hospital Bldg. Co. v. Trustees of Rex Hospital*, 425 U.S. 738 (1976).

services and little, if any, effect on health care costs.¹⁵⁸

The impetus behind health planning was originally local. In the 1940s voluntary planning agencies in several major cities were organized to encourage more rational development of local health facilities.¹⁵⁹ The federal government first became involved in health facility planning in 1946 when Congress established the Hill-Burton hospital construction program.¹⁶⁰ Hill-Burton was intended to remedy the critical shortage of hospital facilities that had developed during the Depression and the Second World War.¹⁶¹ Grants to states were authorized for surveying needs and developing state plans for the construction of hospitals and public health centers.¹⁶² Proposed facilities that conformed to federal standards and to the plan developed by the state Hill-Burton agency were eligible for federal assistance.¹⁶³ The requirement that a single state agency establish priorities based on "need" was a novel feature of the program.¹⁶⁴

Hill-Burton was remarkably successful in stimulating hospital construction and renovation, particularly in small communities in the poorer states.¹⁶⁵ Yet the program's achievements highlighted its limitations. The great bulk of Hill-Burton funds were channeled into hospital projects, while the need for ambulatory facilities was largely ignored.¹⁶⁶ Moreover, Hill-Burton agencies could only support construction that they deemed appropriate; they had no authority to curb unneeded projects.

158. For an early review of literature on certificate of need and other health planning programs, see O'DONOGHUE, EVIDENCE ABOUT THE EFFECTS OF HEALTH CARE REGULATION 59-69 (1974). The major studies of the effects of certificate of need programs are reviewed in Blumstein & Sloan, *Health Planning and Regulation Through Certificate of Need: An Overview*, 1978 UTAH L. REV. 3, 23-30. For a more comprehensive review and analysis of the certificate of need literature, see D. Cohodes, C. Cerf & J. Cromwell, *supra* note 113.

159. Gottlieb, *A Brief History of Health Planning in the United States*, in REGULATING HEALTH FACILITIES CONSTRUCTION 7, 11-12 (C. Havighurst ed. 1974).

160. Hospital Survey and Construction Act of 1946, Pub. L. No. 79-725, 60 Stat. 1040 (codified in scattered sections of 24, 31, 33, 42, 46, 48, 49 U.S.C.). See generally J. LAVE & L. LAVE, THE HOSPITAL CONSTRUCTION ACT: AN EVALUATION OF THE HILL-BURTON PROGRAM, 1948-1973 (1974).

161. See J. LAVE & L. LAVE, *supra* note 160, at 7.

162. Hospital Survey and Construction Act of 1946, Pub. L. No. 79-725, §§ 612-13, 60 Stat. 1040.

163. *Id.* §§ 621-25.

164. See McCarthy, *Planning for Health Care*, in HEALTH CARE DELIVERY IN THE UNITED STATES 346, 354 (S. Jonas ed. 1977). The Hill-Burton formula for determining need, while increasingly criticized as expansionist in effect, remains influential. For an excellent critique of "demand-based" planning methods, see W. McCLURE, *supra* note 71, at 70-73. See also Bovbjerg, *supra* note 87, at 100-09.

165. See J. LAVE & L. LAVE, *supra* note 160, at 2.

166. *Id.* at 13-14.

While Hill-Burton established a federal presence in health facilities construction, the Regional Medical Program (RMP), created in 1965,¹⁶⁷ signalled an incipient federal interest in functional planning. The original Administration proposal contemplated a network of new "regional medical complexes," integrating research, education, and patient care, to combat heart disease, cancer, and stroke. After intense AMA lobbying, the bill was watered down beyond recognition.¹⁶⁸ RMPs were assigned the vague and circumscribed task of establishing "regional cooperative arrangements" among medical schools, research institutions, and hospitals for research, training and demonstration projects related to the "killer diseases." They were admonished to do so "without interfering with the patterns, or the methods of financing of patient care or professional practice, or with the administration of hospitals."¹⁶⁹ In practice, RMPs simply subsidized the pet projects of university medical centers.¹⁷⁰ After absorbing \$600 million in a decade,¹⁷¹ RMPs had little to show for their efforts.¹⁷²

In 1966, Congress authorized funding for the establishment of a national network of state and local Comprehensive Health Planning (CHP) agencies.¹⁷³ This "Partnership for Health" suffered from some of the same defects that crippled RMP: diffuse, poorly defined objectives and an explicit statutory mandate not to interfere with "existing patterns of private professional practice of medicine."¹⁷⁴ The local planning agencies were poorly equipped either to plan or to regulate. Their only comprehensive authority was to "review and comment" on requests for federal funds from institutions within their area. Chronically understaffed, excessively dependent on local sources of funding,

167. Heart Disease, Cancer, and Stroke Amendments of 1965, Pub. L. No. 89-239, 79 Stat. 926 (codified at 42 U.S.C. §§ 299-299i (1976)).

168. See B. EHRENREICH & J. EHRENREICH, *supra* note 29, at 218.

169. 42 U.S.C. § 299(d) (1976).

170. See B. EHRENREICH & J. EHRENREICH, *supra* note 29, at 219-31.

171. Ostow & Brudney, *Regional Medical Programs*, in REGIONALIZATION AND HEALTH POLICY, 60, 64 (E. Ginzberg ed. 1977) (DHEW Pub. No. HRA 77-623).

172. While admitting that RMPs had few demonstrable achievements, some commentators contend that the program's value lay in its "process." The "essential function of the successful RMP" was "catalyzing change in the patterns of planning and of interaction of competing provider institutions, and sensitizing them to regional health imperatives." These alleged successes were admittedly "unquantifiable," of "low visibility" and "impossible to demonstrate." *Id.* at 65. Another commentator identifies the accomplishment of RMPs as "facilitating cooperative health care planning." McCarthy, *supra* note 164, at 359. Again, supporting documentation is singularly weak.

173. Comprehensive Health Planning and Public Health Services Amendments of 1966, Pub. L. No. 89-749, 80 Stat. 1180 (codified as amended at 42 U.S.C. §§ 243, 246, 247a (1976)).

174. *Id.* § 2(a).

and dominated by provider representatives, CHP agencies were ineffective in exercising even this limited power.¹⁷⁵

While the federal government encouraged voluntary planning, several states turned to direct regulation of health facilities construction. New York adopted the first certificate of need (CON) law in 1964.¹⁷⁶ By September, 1978, CON statutes were in effect in thirty-eight states.¹⁷⁷

Certificate of need laws authorize a designated agency to regulate the construction or expansion of institutional health facilities.¹⁷⁸ State programs vary considerably in administrative structure, and procedures for review and appeal.¹⁷⁹ Almost all programs cover hospitals and nursing homes; most include some other facilities such as laboratories and outpatient clinics. Capital expenditures above a specific threshold (typically \$100,000) are subject to review. Most states delegate review authority to their local health planning agencies, but the final decision on approval or denial remains with the state agency designated to administer the program. In almost all states that have enacted such legislation, a certificate of need is a precondition to licensure.

In 1972, Congress adopted the certificate of need concept and gave state health planning agencies another potential source of regulatory control. Under section 1122 of the Social Security Act, states were given the option of establishing, by contract with HEW, a program to

175. See generally B. EHRENREICH & J. EHRENREICH, *supra* note 29, at 198-213; O'Connor, *Comprehensive Health Planning: Dreams and Realities*, 52 MILBANK MEM. FUND Q. 391 (1974); West & Stevens, *Comparative Analysis of Community Health Planning: Transition from CHPs to HSAs*, 1 J. HEALTH POL. POL'Y & L. 173 (1976).

176. Metcalf-McCloskey Act of 1964, ch. 730, 1964 N.Y. Laws 1883 (codified as amended in scattered sections of N.Y. PUB. HEALTH LAW (McKinney 1978)). See Curran, *A National Survey and Analysis of State Certificate-of-Need Laws for Health Facilities*, in *REGULATING HEALTH FACILITIES CONSTRUCTION* 85, 88 (C. Havighurst ed. 1974).

177. Bloom & Bernstein, *Report from Washington*, TRUSTEE, Sept. 1978, at 11. The tremendous rise in health care costs provided the impetus behind the certificate of need plan. Legislatures recognized that "unnecessary construction or modification of health care facilities increases the cost of care and threatens the financial ability of the public to obtain necessary medical services." Curran, *supra* note 176, at 85 (quoting Law of June 1, 1971, ch. 628, § 1, 1971 Minn. Laws 1165).

After initial opposition, the American Hospital Association (AHA) endorsed the certificate of need concept in 1968. With AHA support, CON statutes were passed in rapid succession. *Id.* at 87, 89. The AHA's interests in regulation are complex. Established hospitals undoubtedly see CON as an opportunity to solidify their control over the local market and to prevent the entry of vigorous competitors, especially proprietary hospitals and HMOs. Havighurst, *supra* note 86, at 1178-88. They may also hope that CON will strengthen the ability of administrators and trustees to resist excessive demands for capital expenditures by the medical staff.

178. See generally Havighurst, *supra* note 86.

179. LEWIN & ASSOCIATES, *NATIONWIDE SURVEY OF STATE HEALTH REGULATIONS* 50-54, 166-94 (1974); Havighurst, *supra* note 86, at 1169-78.

review institutional capital expenditures.¹⁸⁰ Health facilities engaging in such expenditures without the prior approval of the state's designated 1122 planning agency would receive a pro rata reduction in the reimbursement for services rendered under Medicaid and Medicare.¹⁸¹ By 1978, thirty-six states had opted to participate.¹⁸² Although this "federal certificate of need program" has never been fully implemented, it clearly indicated an increased federal interest in regulatory strategies.¹⁸³

In the early 1970s, a welter of federal, state and local agencies shared the task of planning and regulating the development of health facilities. The National Health Planning and Resources Development Act of 1974¹⁸⁴ was an ambitious attempt to bring order and direction to these disjointed efforts. CHP, RMP and Hill-Burton were effectively superseded by a single program combining planning, developmental and regulatory functions.¹⁸⁵ Certificate of need programs became integral parts of the system.

The National Health Planning Act has been reviewed in detail elsewhere.¹⁸⁶ The most important features that bear on health facilities regulation are noted below:

(1) The Act provides for a significantly greater role for the federal government. The Secretary of HEW is instructed to issue national health planning guidelines respecting the supply, distribution and organization of health resources and services.¹⁸⁷ State and area health

180. Social Security Amendments of 1972, Pub. L. No. 92-603, § 221, 86 Stat. 1329 (codified at 42 U.S.C. § 1320a-1 (1976)).

181. 42 U.S.C. § 1320a-1(d) (1976).

182. See Kopit, *Hospital Decertification: Legitimate Regulation or a Taking of Private Property?*, 1978 UTAH L. REV. 179, 181 (citing DIVISION OF REGULATORY ACTIVITIES, BUREAU OF HEALTH PLANNING AND RESOURCES DEVELOPMENT, DHEW, STATUS OF CERTIFICATE-OF-NEED AND SECTION 1122 PROGRAMS IN THE STATES (1978)).

The enactment of the National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (codified at 42 U.S.C. §§ 300k-300t (1976)), has made the future of 1122 programs problematical. For a prognosis, see Hanley, *Regulation of Health Facilities and Services Under Public Law 93-641*, in HEALTH REGULATION: CERTIFICATE OF NEED AND 1122, at 53, 58 (H. Hyman ed. 1977).

183. See Wing & Sifton, this Symposium, at text accompanying note 39.

184. Pub. L. No. 93-641, 88 Stat. 2225 (1974) (codified at 42 U.S.C. §§ 300k-300t (1976)).

185. The earlier federal planning legislation was never repealed, but after a transitional period, no further appropriations were made to support the programs.

186. See K. WING, THE LAW AND THE PUBLIC'S HEALTH 137-42 (1976); Atkisson & Grimes, *Health Planning in the United States: An Old Idea With a New Significance*, 1 J. HEALTH POL. POL'Y & L. 295 (1976); Blumstein & Sloan, *supra* note 158, at 8-19. The authors are particularly indebted to Blumstein & Sloan's succinct, yet comprehensive, discussion.

187. 42 U.S.C. § 300k-300l (1976).

plans must be consistent with national standards.¹⁸⁸ While participation is in theory voluntary, states that fail to adopt a planning system meeting the Act's requirements risk losing federal assistance under a variety of health-related programs.¹⁸⁹

(2) Unlike the CHP agencies, which could merely review and comment, the Health Systems Agencies (HSAs) created by the Act have the power to review and *approve* or *disapprove* applications from their area for federal funds under specified programs.¹⁹⁰

(3) The Act requires each state to adopt an approved certificate of need program by 1980.¹⁹¹ According to federal regulations, the certificate of need law must cover "[t]he construction, development, or other establishment of a new health care facility or health maintenance organization."¹⁹² An expenditure above \$150,000 will trigger review by the HSA,¹⁹³ as will changes involving ten beds or ten percent of capacity.¹⁹⁴ General criteria for certificate of need review are established by regulation.¹⁹⁵ The HSA may pursue an administrative appeal if its recommendations are not accepted by the state planning agency.¹⁹⁶

Two other provisions of the Act are of limited immediate significance, but suggest possible directions for government intervention in the future. First, HSAs are required to review periodically *existing* institutional health services and make recommendations to the state agency regarding their "appropriateness."¹⁹⁷ There is no power, however, to eliminate services that are found to be unneeded.¹⁹⁸ Second,

188. *Id.* § 300/-2(b)(2).

189. *Id.* § 300m-(d). Failure to comply could entail loss of funding under the Public Health Service Act, the Community Mental Health Centers Act, and the Comprehensive Alcohol Abuse and Alcoholism Prevention, Treatment, and Rehabilitation Act of 1970. The courts have held that this use of the congressional spending power is not unduly coercive. *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

190. 42 U.S.C. § 300/-2(e)(1)(A) (1976). Funds appropriated under the Public Health Service Act, the Community Mental Health Centers Act, sections 409 and 410 of the Drug Abuse Office and Treatment Act, and the Comprehensive Alcohol Abuse and Alcoholism Prevention, Treatment and Rehabilitation Act of 1970 are subject to HSA review.

191. *Id.* § 300m-2(a)(4)(A).

192. 42 C.F.R. §§ 122.304(a)(1), 123.404(a)(1) (1978).

193. *Id.* §§ 122.304(a)(2), (b)(1), 123.404(a)(2), (b)(1).

194. *Id.* §§ 122.304(a)(3), 123.404(a)(3).

195. *Id.* §§ 122.308, 123.409.

196. 42 U.S.C. § 300m-1(b)(13) (1976). See also 42 C.F.R. § 123.407(a)(9) (1978).

197. 42 U.S.C. § 300/-2(g) (1976). For a useful analysis of the legal issues surrounding appropriateness review, see Cole, *Issues and Strategies in Appropriateness Review: A Legal Analysis*, in *PRELIMINARY APPROACHES TO APPROPRIATENESS REVIEW UNDER P.L. 93-641*, at 89 (M. Mandel ed. 1978). See also Weiner, *Appropriateness Review and Rate Setting*, in *id.* at 39.

198. The Senate version of the bill would have granted this authority. See Kopit, *supra* note 182, at 182.

the Act provides funding to support rate review experiments in six selected states.¹⁹⁹ Only a few states have initiated rate review programs, but federal financial support may encourage others to do so.²⁰⁰

Opposition by providers may be sufficiently strong to resist further extensions of government control. Nevertheless, it is worth noting those regulatory proposals that are likely to be given serious consideration.

If certificate of need programs prove to be ineffective, more drastic measures may be adopted to limit capital expenditures. The Carter Administration's hospital cost containment proposal²⁰¹ included provisions that would have established an annual capital expenditure limitation of \$2.5 billion. The limit would be apportioned among the states, and no state program could grant certificates of need in excess of its allotment.²⁰²

It has been proposed that certificate of need programs be supplemented by regulatory authority to decertify institutions when there is existing excess capacity.²⁰³ In fact, the Senate version of the National Health Planning Act would have required participating states to include decertification authority in their certificate of need program²⁰⁴; this provision was amended, however, to become the more timid "appropriateness review" authority ultimately enacted.²⁰⁵ One state has enacted comprehensive decertification authority, although it has never been used.²⁰⁶

Whether these or other, more serious measures²⁰⁷ will be adopted depends in large part on whether the cost problem can be reduced to a politically tolerable level. Carter's cost containment proposal was defeated under peculiar circumstances: hospital representatives made commitments to the Congress that the industry, through its own orga-

199. 42 U.S.C. § 300m-5 (1976).

200. See Weiner, *Participatory Procedure and Political Support for Hospital Cost Containment Programs: Limits of Open Administrative Process*, this Symposium.

201. See Wing & Sifton, this Symposium, at text accompanying notes 39-57.

202. H.R. 6575, 95th Cong., 1st Sess. (1977) (Title II). See Wing & Sifton, this Symposium, at note 50.

203. Kopit, *supra* note 182.

204. S. 2994, 93d Cong., 2d Sess. (1974). See S. REP. NO. 1285, 93d Cong., 2d Sess. 53, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 7842, 7892.

205. 42 U.S.C. § 300l-2(g) (1976). See Kopit, *supra* note 182, at 182.

206. N.Y. MENTAL HYG. LAW § 13.15 (McKinney 1978); N.Y. PUB. HEALTH LAW § 2806-a (McKinney 1977); see Kopit, *supra* note 182, at 186.

207. A temporary moratorium on hospital construction has been proposed. B. ENSMINGER, *supra* note 86, at 71-72; FUCHS, *supra* note 53, at 151; GOVERNMENT RESEARCH CORPORATION, A FRAMEWORK FOR CAPITAL CONTROLS IN HEALTH CARE 3-4 (1978).

nized "Voluntary Effort," would bring about at least a 2% annual reduction in hospital inflation.²⁰⁸ Whether this effort will be successful and, if successful, sufficient, remains to be seen. Its success may forestall further governmental regulation; its failure may provide the political justification for more serious controls.

III. CONCLUSION

The preceding summary of the American health care delivery system as it exists today reflects a basic and growing conflict: the consumer, with growing expectations of health services frustrated by the inflating cost of those services, is confronted with a system of health care providers with little willingness or economic incentive to reduce costs. Government attempts to resolve this conflict have thus far been ineffective. Tentative regulatory initiatives, fashioned more by political considerations than by any notion of sound, coordinated public policy, have had little measureable success; yet this lack of success has only increased the pressures to do "something" and created a climate in which more drastic measures, once thought to be unnecessary or inappropriate, are now being considered.²⁰⁹

At the heart of the conflict lies the problem of cost—an aggregate total of \$180 billion in 1978, predicted to exceed \$200 billion by 1980.²¹⁰ Health care costs consume 10% of the federal budget and as much as 8% of the budget of some state governments.²¹¹ The cost of health care is not just one of many examples of inflation in an inflationary economy; it is a significant cause of inflation in the economy in general. A few economists argue that the seriousness of the cost problem has been overblown. The cost of health care may be 8.6% of the GNP, but we are, apparently, tolerating that level of spending; and there is no reason to believe that a nation as wealthy as ours cannot spend 10% or even 15% of its resources on its health care. That may be the price we must pay for what we want.

Such rationalizations can, however, only temporarily ease the tension. If \$180 billion is an acceptable level of spending, \$200 billion or \$240 billion or whatever lies ahead will not be so easily tolerated. The problem is not just the absolute level of spending; it is the inflation and the inflation of inflation. At some point, if the costs of health care con-

208. See Wing & Silton, this Symposium, at note 41.

209. *Id.* at text accompanying notes 39-71.

210. See note 4 *supra*.

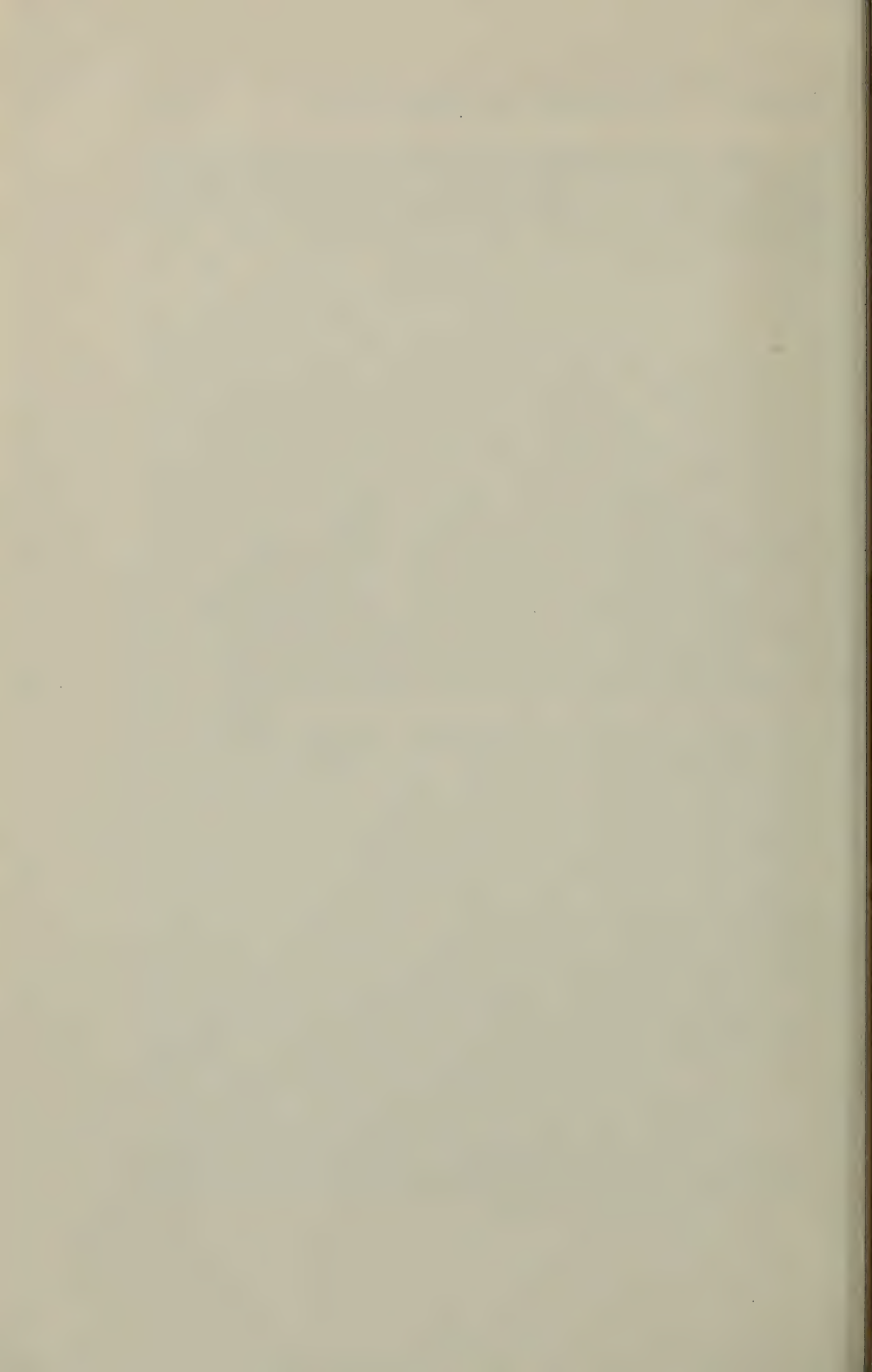
211. See note 5 *supra*.

tinue to rise, the problem will grow to the point at which it cannot be avoided or muted by marginal adjustments or by shifting the economic impact of that cost. Cutbacks in state Medicaid budgets or closures of public hospitals may lessen that impact on state or local government and shift the burden to consumers; we may even go through the motions of enacting some sort of nationalized health insurance scheme, achieving a more equitable distribution of costs at the expense of more aggregate inflation. But simply shifting the burden from one level of government to another, or from the consumer to the taxpayer—or vice versa—can at best provide only temporary relief. Unless cost is controlled, the conflict has to escalate to a confrontation. We are not simply making an allocation of resources; we are trying to achieve both economy and efficiency. We want at least the level of services we now receive, but we no longer are satisfied with the resulting cost. Thus, we are increasingly willing to mandate government intervention into the decisionmaking of health care providers. Today, political considerations may have forestalled cost containment, decertification or even the procompetition strategies preferred by the free market theorists, but we have not avoided the problem. We may at the moment prefer "Voluntary Effort" to an increase of government control, but unless the problem of cost can be resolved, the political reality of tomorrow may be quite different.

The likely response is predictable: incremental increases in regulatory controls and more serious efforts under existing programs. Yet it is possible that this too will be unsuccessful. The regulatory strategy may be unworkable in practice, or it may be theoretically unsound. No amount of coercion, regulation, or financial incentives may be sufficient to reorient the existing system of ostensibly private providers in a direction acceptable to the public. At that point, a major restructuring may be the only alternative. This could be in the form of the more elaborate systemic revisions suggested by Havighurst and others—literally creating more competition by creating more competitors—or it could mean public ownership of health care resources, either in the form of a nationalized health service or by creation of a publicly owned alternative competitor. Already we have reached the point at which such previously heretical alternatives can be seriously discussed.

But these are the alternatives of last resort and the choices of circumstances that have not yet materialized. Rather, in the short run, we are likely to take a series of incremental steps towards increased government control, a more serious testing of the regulatory strategy, but

not a major departure from the basic structure of our system. Our focus, therefore, can be appropriately directed toward existing regulatory efforts and the lessons they demonstrate for both the near and distant future.



PARTICIPATORY PROCEDURE AND POLITICAL SUPPORT FOR HOSPITAL COST CONTAINMENT PROGRAMS: LIMITS OF OPEN ADMINISTRATIVE PROCESS

STEPHEN M. WEINER†

I. INTRODUCTION

A. "Reluctant Agencies" and "Reformist Agencies"

A principal concern of modern administrative law is the capability of persons interested in and affected by administrative actions to have adequate opportunity to present their views in the agency's decision-making processes. This concern is reflected in major doctrinal developments concerning the standards applicable to judicial review of the actions of administrative agencies possessing broad statutory grants of discretionary authority.¹ Similar concerns are reflected in efforts to fashion judicial and statutory principles intended to extend the legal

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1. See, e.g., *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971), in which the Supreme Court discussed the relevant standard applicable upon judicial review of an agency action—in that case, the determination of the Secretary of Transportation to authorize federal funds to construct a highway through Overton Park in Memphis, Tennessee. Construing the provisions of § 10(e)(2)(A) of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (1976), that an action may be overturned if found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," the Court stated:

To make this finding the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency.

Id. at 416. See also Wright, *The Courts and the Rule-making Process: The Limits of Judicial Review*, 59 CORNELL L. REV. 375 (1974).

The standard enunciated by the Supreme Court suggests two principles: that in arriving at its decision the agency should give evidence that it has considered various perspectives on the relevant issue before the agency, not merely the views of one of the affected parties; and that the

capacity of interested parties to participate effectively in agency proceedings.² The multiple sources for this concern include the following: the belief that agencies, particularly regulatory agencies, tend to favor better organized and better financed interests at the expense of inadequately represented perspectives³; a sense that administrative agencies become increasingly isolated from and indifferent to outside interests, that is, become "bureaucratized" and pursue their own self-interest⁴; the recognition that governmental agencies require access to multiple sources of information to ascertain what is in the public interest, and that this information is best provided by directly affected interests⁵; a

reviewing court's responsibility is nonetheless a narrow one, not permitting it to question the policy judgments of the agency to the extent there has been no "clear error of judgment." *Id.*

For a discussion of the meaning of "clear error of judgment" in *Overton Park* and the possible confusion arising from the Court's use of that term in the context of that case, see *Ethyl Corp. v. EPA*, 541 F.2d 1, 34 n.74 (D.C. Cir.), *cert. denied*, 426 U.S. 941 (1976).

With respect to the first principle gleaned from the *Overton Park* standard, compare *Automotive Parts & Accessories Ass'n v. Boyd*, 407 F.2d 330 (D.C. Cir. 1968), in which, in the context of a rulemaking proceeding, the court stated that one of its functions was to assure that "the disappointed have had the opportunity provided by Congress to try to make their views prevail." *Id.* at 343.

2. With respect to standing to participate in an agency proceeding, see *Office of Communications of the United Church of Christ v. FCC*, 359 F.2d 994 (D.C. Cir. 1966).

With respect to the financing of public participation in agency proceedings, see 15 U.S.C. § 57a(h)(1) (1976) (financing of public participation in Federal Trade Commission proceedings); W. GELLHORN & C. BYSE, *ADMINISTRATIVE LAW: CASES AND COMMENTS* 729-30 (6th ed. 1974).

With respect to standing to challenge an agency action, see *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 (1976); *United States v. SCRAP*, 412 U.S. 669 (1973); *Sierra Club v. Morton*, 405 U.S. 727 (1972); *Association of Data Processing Serv. Organizations v. Camp*, 397 U.S. 150 (1970).

With respect to efforts to assure that adequate consideration is given to all affected interests, see *Automotive Parts Accessories Ass'n v. Boyd*, 407 F.2d 330 (D.C. Cir. 1968); *Office of Communications of the United Church of Christ v. FCC*, 359 F.2d 994 (D.C. Cir. 1966). See also *ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, 1971-1972 REPORT* at 11-12, 37-38 (1972).

Further indications of the movement toward enhancing the possibility and quality of general public participation in agency proceedings include the trend toward favoring rulemaking over adjudication as the mode for agency policy development, see *National Petroleum Refiners Ass'n v. FCC*, 482 F.2d 672 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1975), and enactment of the Freedom of Information Act and its subsequent amendment to strengthen the public's capacity to obtain disclosable agency documents, see Pub. L. No. 89-554, § 552, 80 Stat. 383 (1966) (codified as amended at 5 U.S.C. § 552 (1976)).

See generally Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1723-90 (1975).

3. See *Moss v. CAB*, 430 F.2d 891, 902 (D.C. Cir. 1970); *Office of Communications of United Church of Christ v. FCC*, 425 F.2d 543, 549-50 (D.C. Cir. 1969); G. ROSENBAUM, *THE POLITICS OF ENVIRONMENTAL CONCERN* (1973); Cramton, *The Why, Where and How of Broadened Public Participation in the Administrative Process*, 60 GEO. L.J. 525 (1972); Stewart, *supra* note 2, at 1684-85; Danfield, *Representation for the Poor in Federal Rulemaking*, 67 MICH. L. REV. 511 (1969).

4. E. TROXEL, *THE ECONOMICS OF PUBLIC UTILITIES* 69-70 (1947); Cutler & Johnson, *Regulation and the Political Process*, 84 YALE L.J. 1395, 1404-05 (1975); Leone, *Public Interest Advocacy and the Regulatory Process*, 400 ANNALS 46, 50-51 (1972).

5. G. STIGLER & F. COHEN, *CAN REGULATORY AGENCIES PROTECT THE CONSUMER?* 15

skepticism that the minimal notice and comment provisions of traditional administrative rulemaking procedures are not conducive to a broad public awareness of the significant policy issues that the agencies are addressing⁶; and the increasing technical sophistication of agencies and the incapacity of many interested parties, absent highly developed organizational and financial resources, to provide useful comments.⁷

These concerns generally proceed from what may be considered the model of the "reluctant agency." This is an agency that possesses significant discretionary authority vested by statute and that chooses, deliberately or otherwise, to exercise its authority for the benefit of the most economically and politically influential groups affected by its decisions. This may be done passively by relying, for example, on ambiguous statutory mandates for change to justify making no change, perpetuating thereby the prevailing power relationships⁸; or it may be done actively by specifically making decisions to favor strong interests.⁹ In either circumstance, the agency is able to effectively preclude meaningful participation in its policy development and decisionmaking processes by less powerful or articulate groups.¹⁰ Critics of this type of agency assume, at least in part, that increased participation by more diverse interests may modify the substance of agency decisions.¹¹

Not all administrative or regulatory agencies, however, fall into the model of the "reluctant agency." Some agencies, at least during some periods of their history, determine to exercise their discretionary

(1971); Stewart, *supra* note 2, at 1686; Gellhorn, *Public Participation in Administrative Proceedings*, 81 YALE L.J. 359, 377-78 (1972).

6. See, e.g., *United States v. Nova Scotia Food Products Corp.*, 568 F.2d 240, 251-52 (2d Cir. 1977); *National Welfare Rights Organization v. Mathews*, 533 F.2d 637, 648 (D.C. Cir. 1976); *Rodway v. U.S. Dep't of Agriculture*, 514 F.2d 809, 814, (D.C. Cir. 1975).

7. See, e.g., J. MASHAW & R. MERRILL, *INTRODUCTION TO THE AMERICAN PUBLIC LAW SYSTEM: CASES AND MATERIALS* 292-93 (1975).

8. See generally Rosenblatt, *Health Care Reform and Administrative Law: A Structural Approach*, 88 YALE L.J. 243 (1978).

9. G. SCHUBERT, *THE PUBLIC INTEREST* 119 (1960); Green & Nader, *Economic Regulation vs. Competition: Uncle Sam the Monopoly Man*, 82 YALE L.J. 871, 876 (1973). See also Geller, *A Modest Proposal for Modest Reform of the Federal Communications Commission*, 63 GEO. L.J. 705 (1975).

10. Support for this result of agency action or inaction may have been provided in part by the Supreme Court in *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978). The decision, establishing the specific requirements of the APA as maximum procedural requirements, may cast doubt on the continuing validity of such cases as *Mobil Oil Corp. v. FPC*, 483 F.2d 1238 (D.C. Cir. 1973), but would not appear to affect the trends and policies described in notes 1 & 2, *supra*. See also Rosenblatt, *supra* note 8, at 322-26.

11. Rosenblatt, *supra* note 8, at 255.

authority to reallocate economic power.¹² These "reformist agencies" are characterized by: (1) a willingness to perceive the "public interest" as other than the interests of the dominant firms in the regulated industry; (2) efforts to develop procedural devices for encouraging broader participation in and awareness of the significance of decisionmaking processes that the agency undertakes; and (3) attempts to produce decisions that may substantially alter customary practices or traditional relationships in the industry subject to regulatory authority.

One may expect a reformist agency to generate considerable political opposition as it engages in efforts to reallocate existing political and economic resources. To a substantial extent, it may be theorized, its success depends on the explicitness of its statutory authority, the extent to which that statutory authority represents a continuing public political commitment to the agency's objectives, and the relationship between industry interests and nonindustry interests in monitoring and evaluating the agency's activities.¹³

Much analysis of administrative law focuses on the "reluctant agency."¹⁴ Relatively little study has been devoted to the reformist model, particularly the political process that surrounds the reformist agency's efforts to achieve its objectives. This article will consider only one type of reformist agency, that concerned with hospital cost containment, and will focus specifically on a relatively limited question: whether openness of the agency's decisionmaking processes to broad public participation—an objective sought by many of the critics of the reluctant agency¹⁵—correlates with general political support for the agency's programs and objectives. The article is not intended to provide a detailed framework for analysis of the "reformist agency" model, but to serve as a starting point for further analysis.

B. Hospital Cost Containment Agencies as "Reformist Agencies": The Massachusetts Experience

Many of the health regulatory agencies concerned with hospital cost containment objectives tend, at least initially, to fall within the "re-

12. See Lazarus & Onek, *The Regulators and the People*, 57 VA. L. REV. 1069, 1083-84 (1971) (description of role of Federal Trade Commission under chairmanship of Miles Kirkpatrick).

13. See M. BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* 263-71 (1955).

14. See, e.g., *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402 (1971); *Moss v. CAB*, 430 F.2d 891 (D.C. Cir. 1970); *Office of Communications of the United Church of Christ v. FCC*, 425 F.2d 543 (D.C. Cir. 1969); Lazarus & Onek, *supra* note 12.

15. See, e.g., Lazarus & Onek, *supra* note 12.

formist" model: many agency policymakers perceive their role as attempting to restructure traditional relationships in the hospital service delivery system as a means of achieving cost containment objectives. In Massachusetts, for example, a variety of statutory and administrative programs have developed over the past eight years that attempt to alter traditional power relationships and decisionmaking processes in the hospital sector.¹⁶ The programs have sprung up out of concern for the adverse societal and economic consequences of rapid increases in hospital costs¹⁷; their cost containment objectives are thus viewed as being in accord with the "public interest." The logical products of such a commitment are efforts to produce a restructuring of the hospital delivery system and a realignment of existing economic relationships.

Two programs have been established by explicit statutory authority; a third effort, which is not yet sufficiently coherent to warrant being called a "program," encompasses attempts to shrink the size of the existing hospital sector by closing or merging services or whole institutions.

The two explicit statutory programs are "determination of need" (DON)¹⁸ and hospital budget review and approval (Chapter 409).¹⁹ DON is administered by the Department of Public Health (DPH), and provides for review and approval by DPH of hospital applications to undertake substantial capital expenditures and substantial changes in service.²⁰ Under the Chapter 409 program, hospitals must annually file their budgets for review and approval by the Massachusetts Rate Setting Commission (RSC).²¹ Both programs emerged from legislative concerns about the cost of hospital care,²² and therefore commenced

16. See, e.g., Health Planning and Policy Committee of the Commonwealth, *Health Care Expenditures in Massachusetts* 28-43 (1976).

17. *Id.* at 25-27.

18. MASS. ANN. LAWS ch. 111, §§ 25B-25G (Law. Co-op 1975 & Cum. Supp. 1978).

19. *Id.* ch. 6A, §§ 37-44 (Law. Co-op Cum. Supp. 1978).

20. The two jurisdictional terms "substantial capital expenditure" and "substantial change in service" are defined in *id.* ch. 111, § 25B (Law. Co-op 1975 & Cum. Supp. 1978).

21. *Id.* ch. 6A, § 39 (Law. Co-op Cum. Supp. 1978).

22. See Joint Special Committee Established to Make an Investigation and Study of Health Benefits and Health Services for Every Citizen of the Commonwealth and Related Matters, Interim Report, H. No. 5968 (June 1972) (DON) [hereinafter cited as Interim Report of the Joint Special Committee]. The history of Chapter 409 began with Law of July 9, 1975, ch. 424, § 10, 1975 Mass. Acts 449, which directed the Secretary of Human Services to submit "a proposal for a comprehensive system for controlling the costs of purchasing hospital care in the commonwealth." The proposal was submitted in October, 1975, together with draft legislation. See A Proposal From the Secretary of Human Services for a Comprehensive Plan for Controlling the Cost of Purchasing Hospital Services in the Commonwealth (1975). The draft legislation was revised and resubmitted by the Governor in 1976 as H. No. 3160, which became the basis for hearings and deliberations eventually producing Law of Oct. 15, 1976, ch. 409, 1976 Mass. Acts 522.

operations with a background of public support for their objectives. While it may be hypothesized that, even with their reformist objectives, they would not necessarily fall into the model of "reformist agencies,"²³ it does appear that both the DPH and the RSC have taken their responsibilities seriously in making efforts to retard increases in hospital expenditures.²⁴ Since hospitals have become accustomed to making their own decisions on expenditure levels,²⁵ it may be assumed that they have not welcomed these new programs, and that they will attempt to undermine them through formal and informal political techniques.

The capacity of the DPH and the RSC to handle such political pressure is becoming especially important as Massachusetts attempts to move beyond these established programs to pursue a cost containment strategy that calls for "shrinking" the size of the hospital system by forcing the merger or closure of services or entire institutions. Efforts in Massachusetts to date to shrink the hospital system have been successful only when one or more of three characteristics have prevailed: (1) with respect to services, elimination of the service could perceptibly enhance the financial circumstances of the hospital, and perhaps assure a higher level of quality²⁶; (2) with respect to whole institutions, the hospital's financial status has been marginal for reasons not directly related to the cost containment programs; and (3) again with respect to whole institutions, the hospital was providing care of marginal quality, and closure was possible on quality, not cost containment, grounds. Whether shrinking becomes a useful cost containment strategy²⁷ depends on the extent to which the state can promote the closing or partial closing of hospitals on grounds of cost savings alone, and not only in situations in which either the quality of care or the financial well-being of the hospital is already marginal. The political tasks associated with achieving such a result are made more complex because Massa-

23. See, e.g., Rosenblatt, *supra* note 8, at 247-49.

24. See Fielding & Weiner, *Controlling Hospital Costs in Massachusetts*, 299 NEW ENGLAND J. MED. 1249 (1978); Bicknell & Van Wyck, Certificate of Need: The Massachusetts Experience, January 1974-June 1977 (1978) (copy on file in the office of the *North Carolina Law Review*). For an explicit statement on the RSC's cost containment policy, see Statement of Massachusetts Rate Setting Commission Concerning Blue Cross Participating Hospital Agreement HA-27, at 1 (November 10, 1977) [hereinafter cited as RSC HA-27 Statement (1977)].

25. Weiner, "Reasonable Cost" Reimbursement for Inpatient Hospital Services Under Medicare and Medicaid: The Emergence of Public Control, 3 AM. J. L. & MED. 1, 42-46 (1977).

26. See, e.g., Donahue, Pettigrew, Young & Ryan, *The Closure of Maternity Services in Massachusetts: The Causes, Process, and Hospital Impact*, 50 OB. & GYN. 280 (1977).

27. Some question has been raised about the cost efficacy of mergers. See, e.g., Treat, *The Performance of Merging Hospitals*, 14 MED. CARE 199 (1976).

chusetts, unlike New York,²⁸ has no specific statute authorizing the state to decertify facilities. The agencies in Massachusetts concerned with effectuating the "shrinkage" strategy must attempt to achieve the desired policy result using what is at best ambiguous statutory authority.²⁹

Political support strategies derived from this ambiguous statutory authority may of course profit from evidence of strong political support for the DON and Chapter 409 programs themselves. Conversely, the fading of support for even such explicit programs may raise questions about the long-term political viability of the "shrinkage" strategy. In a sense, the legal authority for the implementation of "shrinkage" strategies under DON and Chapter 409 may be a matter of concern secondary to considerations of the political capacities of the respective

28. N.Y. PUB. HEALTH LAW § 2806 (McKinney 1977 & Cum. Supp. 1978).

29. The bill submitted in 1976 by Governor Michael S. Dukakis, H. No. 3160, which initiated the legislative process producing Law of Oct. 15, 1976, ch. 409, 1976 Mass. Acts 522 (codified in scattered sections of MASS. ANN. LAWS ch. 6A (Law. Co-op Cum. Supp. 1978)), contained provisions specifically incorporating into the hospital budget review process the findings from reviews of the appropriateness of institutional services undertaken by the regional and state planning agencies. See H. No. 3160, ch. 6A, § 38(b). Such reviews could produce recommendations for closing or merging services or entire institutions. Although the provision was not adopted, the final version of Chapter 409 does contain language that arguably could permit the RSC to incorporate appropriateness review findings into budget reviews. See Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 522 (requiring adoption of a definition of "reasonable financial requirements"). See also Weiner, *Appropriateness Review and Rate Setting*, in PRELIMINARY APPROACHES TO APPROPRIATENESS REVIEW UNDER P.L. 93-641, at 64-67 (1978). The concept of "appropriateness review" emanates from 42 U.S.C.A. § 3001-2(b) (West Supp. 1979), which requires that health systems agencies undertake such reviews periodically and make findings thereon.

The potential authority in the DPH to pursue a shrinkage strategy is somewhat more speculative. Law of July 18, 1972, ch. 776, § 3, 1972 Mass. Acts 721 (codified as amended at MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op 1975)) provides:

The department, in making any such determination [of need], shall encourage appropriate allocation of private and public health care resources and the development of alternative or substitute methods of delivering health care services so that adequate health care services will be made reasonably available to every person within the commonwealth at the lowest reasonable aggregate cost.

See Interim Report of the Joint Special Committee, *supra* note 22, at 27-28. In addition, Law of July 18, 1972 established a time period within which the DPH was to "approve or disapprove, in whole or in part, or otherwise act" upon an application. *Id.* (emphasis added).

Relying on such language, DPH attempted to condition approvals of pending applications on consolidation or closure activities involving institutions not formally before the Department with a DON application. See Reeder, Mason & Glantz, *Certificate of Need: The Massachusetts Experience*, 1 AM. J. L. & MED. 13, 21-28 (1975). Because of the political response to these efforts, in 1975, the DPH adopted regulations narrowing the scope of conditions that could be attached to a determination, see MASSACHUSETTS DEPARTMENT OF PUBLIC HEALTH, MASSACHUSETTS DETERMINATION OF NEED REGULATIONS (November 9, 1976) [hereinafter cited as MASS. DON REGS.], and in 1977, the legislature eliminated the "or otherwise act" language. See MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op Cum. Supp. 1978) as amended by Law of Jan. 9, 1978, ch. 945, § 4, 1977 Mass. Acts 1363. See also note 131 *infra*.

programs and the ability of the agencies administering them to withstand sustained opposition by affected segments of the hospital industry.

One vehicle available to a "reformist agency" for developing political support in this context from nonhospital interests is the provision of mechanisms for broad public participation in its policy development and decisionmaking processes. In the case of "reluctant agencies," demands by outside groups that the agency provide such mechanisms are usually intended to change the policies of the agency. In the case of "reformist agencies," on the other hand, the agency itself may wish actively to develop and indeed exploit the mechanisms for public participation to provide a means for developing or demonstrating support for the agency's policy goals. Particularly when the agency's objectives are opposed by strong and organized interests, mechanisms for public participation can significantly enhance public visibility and political support for those objectives.³⁰

In considering the continuing viability of such cost containment programs as DON and Chapter 409, and the likelihood of "shrinkage" strategies being successfully implemented, a series of questions must be addressed concerning the relationships among public policy objectives, governmental process, availability of opportunities for public participation in agency decisionmaking, and the development and institutionalization of political support for reformist goals. This article will consider specifically the experiences of DON and Chapter 409 in Massachusetts; features of and lessons derived from these experiences will be of significance as governmental efforts to pursue cost containment objectives through "shrinkage" strategies intensify.

The questions considered are the following:

(1) Do the DON and Chapter 409 programs provide procedural mechanisms that facilitate participation by diverse interest groups in

30. This concept of an agency using open participatory procedures as a vehicle for developing political support is related to notions of "structural due process," which include the view that assuring adequate public participation in agency proceedings may affect substantive outcomes of agency decisions. See generally Rosenblatt, *supra* note 8. The present article moves somewhat beyond the case studies employed by Rosenblatt in that it assumes an affirmative willingness on the part of the regulatory agencies, DPH and RSC, to involve in their proceedings a more cross-sectional array of interest groups than ordinarily participate in regulatory procedures in order to assure that their decisions will be substantially different from those coming from "reluctant agencies." One conclusion that may be derived from the present article is that efforts to produce agency decisions conducive to the broad public interest, at least in the area of health services regulation, involve a far more complex set of tasks than even proponents of "structural due process" might suggest.

their policy formulation and decisionmaking processes and that may provide the structure for developing political support for the programs?

(2) To what extent are these mechanisms in fact used by diverse interests, particularly interests different from and perhaps opposed to the most significant adversely affected economic interests subject to the agencies' authority?

(3) If these procedural mechanisms have not assisted in producing support for the agencies' reformist objectives, what factors exist that might be constraining concerned parties from providing active support for these objectives?

(4) What strategies may be available to DPH and RSC to overcome these constraints and to permit them to develop support for their objectives? Are these strategies transferable to shrinkage objectives for which there is no explicit statutory basis?

The efforts made to answer these questions in this article are preliminary only; more analysis of the characteristics of the "reformist agency" model and more empirical research is necessary to move beyond this preliminary stage. Nevertheless, a preliminary effort to address these questions is worthwhile given the continuing discussions of cost containment strategies at the federal and state levels of government.

II. PROCEDURAL MECHANISMS FOR PARTICIPATION IN AGENCY DECISIONMAKING

DPH and RSC enabling acts and regulations afford a number of opportunities for public participation in major policy activities. The devices that create these opportunities fall generally into three categories: general public notice and comment requirements applicable to proposed regulations under the state's administrative procedure act (APA)³¹; specific, statutorily established advisory or consultative processes³²; and interventions by groups of ten or more taxpayers (ten-taxpayer interventions) in DPH review of DON applications.³³ These categories will be discussed in turn.

A. Public Notice and Comment

The Massachusetts APA establishes two major classes of regula-

31. See text accompanying notes 34-44 *infra*.

32. See text accompanying notes 41-61 *infra*.

33. See text accompanying notes 62-80 *infra*.

tions, those that require public hearings and those that do not.³⁴ A public hearing is required when such a hearing is guaranteed as a matter of constitutional right, when a statute specifically calls for one or when violation of a regulation is punishable by fine or imprisonment. Other regulations may be issued without public hearing prior to adoption.³⁵ In either case the agencies must provide notice of the proposed action or of the public hearing, whether the regulation is being adopted, amended or repealed, within the time specified by the relevant statute, when applicable, or at least twenty-one days prior to the action or hearing.³⁶ Notice must be published; it must also be filed with the Secretary of State and provided to parties who are specified in the relevant statute or who have filed annually a request with the agency to receive notice of actions with respect to proposed regulations.³⁷ If the proposed regulation is not one subject to a public hearing requirement, the agency shall nevertheless "afford interested persons an opportunity to present data, views or arguments in regard to the proposed action orally or in writing."³⁸

With respect to either type of regulation, the agency may adopt regulations on an emergency basis without notice or a public hearing. A regulation that ordinarily requires a public hearing prior to promulgation, however, may, if issued on an emergency basis, remain in effect for no more than three months unless the agency gives notice and holds a public hearing.³⁹

The APA, then, provides a basic framework within which public participation in agency rulemaking may occur. Although DPH's regulations governing the DON program are primarily procedural,⁴⁰ they do contain substantive standards and criteria that have been included in the basic regulation after public hearing.⁴¹ RSC's responsibilities, other than under Chapter 409, must by statute be conducted in accordance with regulations "after public hearing."⁴² Although a public hearing requirement is not specifically included in the provisions governing the Chapter 409 program, hospitals are subject to civil penalties for

34. MASS. ANN. LAWS ch. 30A, § 2 (Law. Co-op Cum. Supp. 1978).

35. *Id.* § 3.

36. *Id.* §§ 2 & 3.

37. *Id.*

38. *Id.* § 3.

39. *Id.* § 2.

40. See MASS. DON REGS., *supra* note 29.

41. *Id.* at pts. 60-65.

42. MASS. ANN. LAWS ch. 6A, § 32 (Law. Co-op Cum. Supp. 1978).

making a charge or accepting payment based on a charge in excess of that approved by the RSC, for failing to file information required by regulations of the Commission or for falsifying such information.⁴³ Consequently, regulations implementing Chapter 409 have been promulgated after public hearing, except when the emergency provisions have been invoked.

B. Advisory or Consultative Processes

Under its organic statute, the RSC is obliged to submit all proposed regulations, including those implementing Chapter 409, at least sixty days prior to promulgation for review and comment by the RSC's Advisory Council.⁴⁴ The Council consists of twenty-three members. Seven are state officials or their designees, serving *ex officio*.⁴⁵ The remaining sixteen members are appointed by the Commission. Eight are to be "providers, or representatives of provider organizations, whose rates of reimbursement are determined by the commission," and eight are to be "non-providers who have demonstrated experience in the field of consumer advocacy and who have no financial interest in any provider of services whose rates of reimbursement are determined by the commission."⁴⁶

Some additional requirements pertain to the provider and the non-provider categories. No provider group may have more than one representative on the Council unless all provider groups or classes are already represented.⁴⁷ Since the RSC establishes rates for more than eight provider groups,⁴⁸ the RSC in fact must decide which provider groups *will not* be represented on the Council at any one time.⁴⁹ Further, within the nonprovider category, two of the eight must be selected

43. *Id.* § 44.

44. *Id.* § 34.

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* § 32 provides that the RSC shall have sole responsibility for establishing "rates to be paid providers of health care services by governmental units, including the division of industrial accidents in the department of labor and industries," and for establishing charges "to be used by state institutions for general health supplies, care, social, rehabilitative or educational services and accommodations." Under this authority the RSC establishes rates or charges for hospitals, skilled nursing facilities, intermediate care facilities, rest homes, physicians, dentists, pharmacists, podiatrists, psychologists, home health agencies, neighborhood health centers, day-care centers, group residence facilities for juvenile offenders, occupational, physical and speech therapists, state public and mental health hospitals and state schools for the retarded, as well as other providers of health rehabilitation and social services.

49. In its first appointment to the Council, the RSC named representatives for the following provider classes: hospitals, long-term care facilities, physicians, pharmacists, home health agen-

from recommendations "by state-wide organizations representing the interests of the elderly," and two from recommendations of statewide labor organizations, with one of the two selected specifically from recommendations of the State Labor Council, AFL-CIO.⁵⁰

The RSC Advisory Council is entitled to sixty days to review and comment on all regulations proposed by the RSC prior to promulgation. It is to receive ten days advance notice of any public meeting or hearing scheduled by the RSC or one of its bureaus.⁵¹ Other rights and responsibilities are more generally stated: it "shall advise on the overall operation and policy of the commission and its bureaus, [and] shall consider any item recommended by the commission, the chairman of the council, a majority of the council members or by a subcommittee."⁵² The enabling act envisions that much of the work of the Advisory Council will be conducted by subcommittees created to correspond directly to the operating bureaus of the RSC, perhaps as a device for developing enhanced expertise and producing more immediate impact on early stages of the process of identifying issues for subsequent policy development.

With respect only to the Chapter 409 program, the statute provides for two review processes in addition to that assigned the Advisory Council. First, in developing regulations governing review of applications for charge modifications submitted by hospitals, the RSC must consult with representatives of Blue Cross of Massachusetts, Inc., the Massachusetts Hospital Association, commercial insurance carriers, and the health systems agencies.⁵³ Similar consultations are mandated before the RSC may adopt a methodology for grouping hospitals and undertaking cost comparisons in approving hospital budgets.⁵⁴ Such consultations are required even if the regulations are promulgated on an emergency basis.

The second review process established by Chapter 409 is carried out by yet another advisory group, the Hospital Policy Review Board.⁵⁵ Unlike the Advisory Council, the Policy Review Board's responsibili-

cies, neighborhood health centers, day-care centers and group residential treatment facilities. RSC Advisory Council files.

50. MASS. ANN. LAWS ch. 6A, § 34 (Law. Co-op Cum. Supp. 1978).

51. The specification of Advisory Council rights is derived from *id.*

52. *Id.* The Chairman of the Advisory Council is to be selected annually from among its non-provider members. *Id.*

53. *Id.* § 37.

54. *Id.* § 40.

55. *Id.* § 34A.

ties are limited to overseeing the RSC's implementation of Chapter 409 alone, and its membership is established not to represent state, provider, and nonprovider interests generally, but to offer a forum for identified interests concerned about or affected by the administration of that program—specifically, hospitals, physicians, health systems agencies, Blue Cross, commercial insurance carriers, business, labor, and the elderly.⁵⁶ Unlike the nonprovider members of the Advisory Council, who are expected to be experienced in consumer advocacy, the Policy Board's nonprovider members are expected to have technical proficiency in matters pertaining to hospital service delivery or financing.⁵⁷

The rights and responsibilities of the Policy Board are more extensive than those of the Advisory Council. It also is entitled to a sixty-day review and comment period with respect to proposed regulations implementing Chapter 409,⁵⁸ but it has the right to more information than merely the language of the proposed regulations themselves, because the RSC must issue an explanatory statement accompanying the proposed regulations.⁵⁹ Unlike the Advisory Council, the Policy Board is obliged to submit written comments on all proposed regulations, recommending approval, disapproval, or partial approval. If the RSC does not accept a recommendation, it must provide the Board with a written statement of its reasons for disagreement. Both the Board's recommendation and the RSC's statement become part of the record of any public hearing held on the proposed regulation. Further, if the Board has recommended against promulgation of a regulation, the RSC must delay promulgation for at least twenty-one days to provide the Board an opportunity to hold a public hearing on the recommendations.

Three additional rights of the Board are significant in determining its relationship to the RSC. First, individual Board members are entitled by statute not merely to present evidence at public hearings held by the RSC on proposed Chapter 409 regulations, but to present wit-

56. *Id.*

57. *Id.*

58. The rights and responsibilities of the Policy Review Board specified in this and the next paragraphs of the text are derived from *id.*

59. There has as yet been no judicial determination with respect to the content or level of detail expected to be included in the explanatory statement. Query whether judicial interpretation of the Administrative Procedure Act, 5 U.S.C. § 553(c) (1977), that an agency "shall incorporate in the rules adopted a concise general statement of their basis and purpose," would be applicable to the RSC's responsibility to provide an explanatory statement. See, e.g., *Amoco Oil Co. v. EPA*, 501 F.2d 722 (D.C. Cir. 1974); *Kennecott Copper Corp. v. EPA*, 462 F.2d 846 (D.C. Cir. 1972).

nesses as well. Second, if four members of the Board (less than a standard quorum) so request, the Board is to hold a public hearing on its own with respect to the RSC's policies and activities carried out under Chapter 409. Finally, the Board is required to report at least annually to the governor and the legislature on its findings, opinions and recommendations for legislation, and copies of this report must be sent to the Joint Legislative Committee on Health Care.

In summary, Chapter 409 provides for consultation with a cross-section of affected interests on the issuance of all regulations, including emergency regulations, and provides further that in issuing final regulations under the program, the RSC must undergo three separate review and comment processes involving a potentially very broad range of interests. These three sets of review procedures are separate and distinct from the required notice and comment procedure under the APA. Finally, at least one of the review processes, that undertaken by the Hospital Policy Review Board, involves technically expert parties and requires a clear explication on the part of the RSC of the policy objectives associated with its implementation of Chapter 409.

The DPH, in promulgating DON regulations, is not required to undergo consultative or review and comment processes similar to those applicable to Chapter 409. The DON statute does, however, provide for participation in the DON rulemaking process by health systems agencies (HSAs), the regional planning agencies established under the National Health Planning and Resources Development Act of 1974.⁶⁰ The participation rights of the HSAs are virtually identical to those of the ten-taxpayer groups described below.⁶¹ The potential significance of the HSAs in the DON rulemaking process is also discussed in Part V below.

C. *Ten-Taxpayer Interventions*

The Massachusetts DON statute authorizes formal participation in the regulatory process by a ten-taxpayer group. Specifically, any such group may request a public hearing on a DON application,⁶² and, if aggrieved by the DPH determination, may file an appeal with the Health Facilities Appeals Board.⁶³ In addition, a ten-taxpayer group

60. 42 U.S.C.A. §§ 300/-1 to 300/-2 (West Supp. 1979).

61. See text accompanying notes 62-80 *infra*.

62. MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op 1975 & Cum. Supp. 1978).

63. *Id.* § 25E (Law. Co-op 1975). The Health Facilities Appeals Board is established under *id.* ch. 6, § 166, as the administrative appellate body for determinations of need made by the DPH

can go to court to enforce the provisions of the Act.⁶⁴

While the vehicle of ten-taxpayer interventions has been used by very diverse interests,⁶⁵ the statutory provision was probably intended primarily to enhance "consumer" participation in the DON process.⁶⁶ Its underlying policy appears to address the need to inform consumers, who then can play an effective role in decisions affecting the health care delivery system. The statute's effort to increase consumer involvement and responsibility is reflected in the composition of the Health Facilities Appeals Board⁶⁷ and in the Act's restructuring of the governing body of the DPH, the Public Health Council, from a physician majority to a nonprovider majority.⁶⁸

DPH regulations implementing the DON program have provided procedural rights to ten-taxpayer groups⁶⁹ beyond those contained in the statute. These are:

(1) Even if a ten-taxpayer group does not request a public hearing, it is afforded a reasonable opportunity to comment on a DON application. DPH is required to consider such comments, if filed in a timely and proper manner, before acting on the application.⁷⁰

under *id.* ch. 111, § 25C (Law. Co-op 1975 & Cum. Supp. 1978). The Board consists of a majority of nonproviders. Its scope of review and procedures with respect to departmental determinations is set forth at *id.* § 25E (Law. Co-op 1975).

64. *Id.* § 25G (Law. Co-op 1975). Although there is no specific provision in the statute for a ten-taxpayer group to seek review of a decision by the Health Facilities Appeals Board, *id.* § 25E provides for judicial review of "final decisions" of the Board under the provisions of *id.* ch. 30A, § 14 (Law. Co-op 1973 & 1978 Cum. Supp.), except to the extent the provisions of that section are inconsistent with the provisions of *id.* ch. 111, § 25E (Law. Co-op. 1975). *Id.* ch. 30A, § 14 (Law. Co-op 1973 & 1978 Cum. Supp.) provides for standing to seek judicial review of final agency decisions by "any person . . . aggrieved by" such decisions. While it would be possible to argue that ten-taxpayer groups with standing to appeal to the Health Facilities Board constitute ten taxpayers aggrieved by adverse final decisions of the Board, a superior court has found that ten taxpayers comprising an intervening group are not "persons aggrieved" within the meaning of the statute. *Shoolman v. Health Facilities Appeals Board*, No. 30373 (Super. Ct., Suffolk Cty., Mass. June 1, 1979).

65. See text accompanying notes 97-110 *infra*.

66. Interim Report of the Joint Special Committee, *supra* note 22, at 40.

67. See note 63 *supra*.

68. MASS. ANN. LAWS ch. 17, § 3 (Law. Co-op Cum. Supp. 1978) provides that the Public Health Council shall consist of the Commissioner of Public Health as Chairman and eight members appointed by the Governor, three of whom shall be providers of health services and five of whom shall be "nonproviders," a term defined in the same section. Prior to 1972, the Council consisted of the Commissioner and six appointed members, of whom three were to be physicians, and until 1975, Massachusetts law required that the Commissioner be a physician. Law of July 7, 1914, ch. 972, § 3, 1914 Mass. Acts 970. The statute now permits a non-physician to serve in the position. MASS. ANN. LAWS ch. 17, § 2 (Law. Co-op Cum. Supp. 1978).

69. MASS. DON REGS., *supra* note 29, § 14, establishes a procedure by which a ten-taxpayer group may duly register with the DPH in order to be assured of the participation rights described in the text accompanying notes 70-80 *infra*.

70. MASS. DON REGS., *supra* note 29, §§ 40.1 & 43.

(2) Comments on hospital applications by appropriate HSAs, the state comprehensive health planning agency, and, when relevant, the Departments of Elder Affairs or Mental Health, are to be submitted to all duly registered ten-taxpayer groups.⁷¹

(3) If DPH's staff prepares a report on an application that rejects specific recommendations submitted in writing by a ten-taxpayer group, the staff report is to be available in the Department's public file for at least twenty-one days before the DPH meeting scheduled to consider the application,⁷² and a copy of the staff report is to be mailed to any affected, duly registered ten-taxpayer group.⁷³

(4) If the staff report rejects a specific recommendation contained in the written comments of a ten-taxpayer group, the group has the right to respond in writing to the Department, provided certain procedural requirements are satisfied.⁷⁴ The group's written response is specifically included in the documentation presented to the Public Health Council when it considers an application.⁷⁵

(5) The Commissioner of Public Health is required to establish the agenda of applications to be considered by the Public Health Council at least seven days prior to its scheduled meeting. No additional applications may then be included on the agenda without the consent of interested parties, including any intervening ten-taxpayer group. At least five days before the scheduled meeting, the Commissioner must provide oral or written notice of the agenda to affected ten-taxpayer groups.⁷⁶ An applicant may request postponement of consideration of his application, but a request is not to be granted if the Commissioner determines that it would prejudice, among others, an affected ten-taxpayer group.⁷⁷ A ten-taxpayer group can itself request postponement, but the regulations indicate that "said request will rarely be granted." Exceptions to this general rule may occur when the Commissioner determines that the request is for good cause and that failure to grant the request will "significantly prejudice the party making the request from having its position considered by the Council."⁷⁸

71. *Id.* § 42.5.

72. *Id.* § 44.3(2). If there is no disagreement between DPH staff and the ten-taxpayer group, the staff report need be in the public file for only seven days. *Id.* § 44.3(1).

73. *Id.* § 44.3(2).

74. *Id.* § 44.4.

75. *Id.*

76. *Id.* § 51.2.

77. *Id.* § 51.3.

78. *Id.*

(6) When an application generates conflicting positions, affected ten-taxpayer groups may make oral presentations to the Council during the meeting at which the application is considered.⁷⁹

Enumeration of these additional rights conferred on ten-taxpayer groups reveals that the regulations go well beyond the skeletal language of the statute to provide possibilities for organized ten-taxpayer groups to have their views heard during departmental deliberations on DON applications.⁸⁰

III. EFFICACY OF PUBLIC PARTICIPATION OPPORTUNITIES IN SUPPORTING PROGRAM OBJECTIVES

The preceding descriptions suggest that statutes or regulations governing operation of the two major cost containment programs in Massachusetts provide substantial opportunity for members of the general public and representatives of nonprovider interest groups to participate in agency proceedings. Indeed in some cases they are able to require the agency to explain its positions or policies that are not consistent with the views of the particular outside interest.

There is no sound methodology to determine whether the "reformist" RSC and DPH have made use of public participation through these devices to develop a political constituency for or general public support of the agencies' decisions. Two types of analysis, however, would indicate whether there is a relationship between the availability of such devices and general support for the cost containment objectives of the DON and Chapter 409 programs. The first is an examination of actual participation in and use of the processes.⁸¹ The second is a determination of the extent to which, despite the opportunities for public participation, external political opposition to the program has developed and had an impact on the program's operation.⁸² Some preliminary information is available for these analyses with respect to Chapter 409 and DON. The information suggests that constructive use of the procedures occurs only in limited situations, and that the availability of the

79. *Id.* § 51.6. The hearing before the Council is not an adjudicatory hearing. *Id.* § 51.1. Therefore, formal cross-examination would ordinarily not occur.

80. See text accompanying notes 62-68 *supra*.

81. See text accompanying notes 83-110 *infra*.

82. Successful opposition to a cost containment program, as represented, for example, by the legislative overrides of DPH decisions under the DON program. see text accompanying notes 111-30 *infra*, may indicate lack of potential support for the program's objectives. On the other hand, the absence of political efforts to undercut a program's efficacy may suggest nothing more than the program's ineffectiveness. See text accompanying notes 128-59 *infra*, for discussion of why there has been little political opposition to administration of the Chapter 409 program.

procedural devices does not necessarily protect the program from effective political opposition.

A. Use of Established Procedural Devices

1. Public Notice and Comment

The devices for public participation in the regulation issuance process have been used relatively infrequently in implementing DON because the regulations that have been issued are primarily procedural. The incorporation of substantive standards and criteria into these regulations generally follows a two-step process. The first is a so-called "generic" process involving widespread consultation among a diverse group of interests outside of any formal procedural structure.⁸³ Ultimately, the results of such an informal consultative process are formulated into proposed regulations processed pursuant to APA requirements. The informal process is significant, and its implications are explored in somewhat greater detail below.⁸⁴ The informal process, of course, does not entail the right of participation, which is a feature of the formal procedural devices discussed earlier.

The RSC promulgates regulations governing administration of Chapter 409 at least annually. No specific interest groups are required to participate in the public notice and comment process, and anyone from the general public may, under agency practice, testify at public hearings or submit written comments into the record of the proceeding. Since the inception of the Chapter 409 program,⁸⁵ nine public hearings have been held on implementing regulations.⁸⁶ All but two of the public hearings consisted exclusively of testimony submitted by RSC staff, hospital representatives, or spokesmen for the Massachusetts Society of Certified Public Accountants, the members of which are responsible for preparing financial information for hospitals. The only other group to be represented at any of the hearings has been the Massachusetts Con-

83. For a description of this process, see MASSACHUSETTS DEPT OF PUBLIC HEALTH, DRAFT STATE HEALTH PLAN §§ 1.15-1.16 (1978). See also Feeley & Feldman, Certificate of Need Regulations, pts. A, C (undated draft prepared for Executive Programs in Health Policy, Planning and Regulation, Harvard School of Public Health).

84. See text accompanying notes 211-220 *infra*.

85. For purposes of this discussion, the Chapter 409 program encompasses not only the program established by Law of Oct. 15, 1976, ch. 409, 1976 Mass. Acts 522 (codified in scattered sections of MASS. ANN. LAWS ch. 6A (Law. Co-op Cum. Supp. 1978)), but also the predecessor interim program established by Law of July 9, 1975, ch. 424, 1975 Mass. Acts 449.

86. Below is a listing of the proposed implementation regulations and hearing dates for both the Chapter 409 program and the predecessor interim program established under Law of July 9, 1975, ch. 424, 1975 Mass. Acts 449 through June 1979:

sumer Council, a state agency responsible for advocating consumer interests generally,⁸⁷ and Blue Cross of Massachusetts, Inc.

This lack of general public participation at the hearings may be explained in part by the highly technical nature of the material included in the regulations. The RSC employs a formula approach⁸⁸ to develop allowable cost, revenue, and charges; accordingly, many of its regulations are devoted to such mathematical constructs as the methodology for calculating cost increases due to inflation in the economy generally⁸⁹ or net increases in the volume of services the hospital provides.⁹⁰ While each of the technical features of such a regulation reflects potentially significant policy decisions, an adequate understanding of the implications of these decisions, because of the technical nature of the materials, is generally beyond the capacity of most persons not trained in the relatively new techniques of rate regulation. Expertise, at least currently, is limited to agency staff, the providers, and some of the groups represented on the Hospital Policy Review Board. Indeed, it may very well be that the lack of participation at Chapter 409 public hearings is a result of the availability of the Hospital Policy Review Board and the consultative processes under Chapter 409 as the focus for participation by those parties that already possess sufficient technical proficiency to understand the intricacies of the proposed reg-

Proposed Regulation	Hearing Date	Legislative Authority
14 CHSR 4	October 3, 1975	Law of July 9, 1975, ch. 424, 1975 Mass. Acts 449
14 CHSR 4	March 16, 1976	<i>Id.</i>
14 CHSR 4	April 27, 1976	<i>Id.</i>
14 CHSR 9	January 10, 17, 1977	Law of Oct. 15, 1976, ch. 409, 1976 Mass. Acts 522
14 CHSR 9	March 21, 1977	<i>Id.</i>
114.1 CMR 4.00	April 18, 1978	<i>Id.</i>
114.1 CMR 8.00	August 9, 1978	<i>Id.</i>
114.1 CMR 8.00*	October 27, 1978	<i>Id.</i>
114.1 CMR 8.00*	January 24, 1979	<i>Id.</i>

* Amendments only

87. The Council is established under MASS. ANN. LAWS ch. 6, § 115 (Law. Co-op 1973). Among its responsibilities is that of informing the public, "through appearances before . . . state . . . commission . . . hearings . . . , of such policies [and] decisions . . . as are beneficial or detrimental to consumers." Its membership consists of the Attorney General, the Chairman of the Department of Public Utilities, the Commissioners of Banks, Insurance, and Labor and Industries, *ex officio*, and eight members appointed by the Governor, of whom one is to be a member of the State Labor Council, AFL-CIO. *Id.*

88. For a general discussion of different approaches to ratesetting, see Bauer, *Hospital Rate Setting—This Way to Salvation?*, 59 MILBANK MEM. FUND Q. 117 (1977).

89. See, e.g., Massachusetts Rate Setting Commission Regulation, 114.1 C.M.R. § 8.11 (1978).

90. *Id.* at 8.12-13.

ulations. Less knowledgeable members of the general public may be constrained by the existence of such mechanisms merely to state support for the general approach of the RSC (to the extent that it may be gleaned from the regulations) or not to participate in the process, with the expectation that more expert parties can capably represent their interests.⁹¹

Whatever the explanation, the availability of public hearings prior to promulgating Chapter 409 regulations has not served to provide the RSC with diverse views, separate from any analyses undertaken by the Hospital Policy Review Board, nor has it therefore enabled the agency to create a general public understanding of its processes and policy objectives.

2. Advisory Council and Review Board

There have been significant differences in the roles played by the RSC Advisory Council and the Hospital Policy Review Board established under Chapter 409.⁹² The Advisory Council had nine vacancies as of January 1, 1979: one in the nonprovider labor category, three in the general nonprovider category and five in the provider category. The only provider groups represented on the Council as of that date were physicians, residential child care programs and day-care services. The Council had not met as a formal body with a quorum present since November 14, 1977. It has never submitted any formal written comments on any proposed RSC regulation, nor has it submitted even informal comments on proposed Chapter 409 regulations.

In contrast, as of January 1, 1979, the Hospital Policy Review Board had met twenty-one times since its formation in February 1977. As required by statute, it had made formal recommendations to the RSC on all proposed Chapter 409 regulations. In a number of instances, it has recommended changes, the substance of which has on all of these occasions been incorporated into the regulations ultimately promulgated. It is significant that the Board generally supports the policies of the RSC and that, when there has been specific disagreement, the RSC has generally accepted the Board's recommendations as being

91. Such an attitude raises the distinct possibility that the administrative agency itself will increasingly assume that it can discern the public interest without the necessity of participation by diverse groups representing different perspectives. For an expression of concern about administrative agencies assuming this responsibility, see *Office of Communications of the United Church of Christ v. FCC*, 359 F.2d 994 (D.C. Cir. 1966).

92. For a description of these bodies, see text accompanying notes 44-58 *supra*. The details concerning meetings and actions of the two bodies are derived from RSC files.

consistent with the objectives of the agency.⁹³

Differences in the composition, rights and responsibilities of the two advisory groups may account for some of these differences in performance. First, the members of the Board are statutorily specified to include the major interest groups that are concerned about and affected by the Chapter 409 program, and some level of technical proficiency in ratesetting issues is either assumed or required.⁹⁴ In contrast, the Advisory Council consists of persons drawn from very diverse interest backgrounds. Their capacity to concentrate on any one set of issues is limited, for example, by the requirement that no more than one member represent any one provider group. There is no established necessity for expertise in ratesetting matters.⁹⁵

Second, the Advisory Council is expected to review all ratesetting regulations, which cover an extensive set of health providers, institutional and noninstitutional, as well as social and educational, service providers. Since the agency issues numerous regulations annually,⁹⁶ it is difficult for the Council to focus consistently on a specific set of policy issues. The Board, on the other hand, considers only one program, can follow its evolution sequentially and can develop a level of sophistication concerning policy choices based on a consistent and continuous familiarity with the program as it unfolds.

Third, the Board's statutory right to demand explanations from the agency when policy differences emerge, and to delay somewhat promulgation of regulations, enables the Board to be a "presence" in agency decisions. If major disputes develop, the Board may initiate its own public hearings and may report its views directly and officially to the governor and to the legislature. These rights, coupled with the expertise possessed by individual Board members, make it a serious force

93. A major policy dispute emerged between the RSC and a majority of Hospital Policy Review Board members with respect to the changes required by Chapter 409 to be implemented by October 1, 1978. See text accompanying notes 152-154 *infra*. The RSC adopted a position closer to that of the Board majority. The resulting proposed amendments to 114.1 CMR 8.00 were the subject of a public hearing held on October 27, 1978.

94. MASS. ANN. LAWS ch. 6A, § 34A (Law. Co-op Cum. Supp. 1978) requires that the non-provider members of the Board have "experience in or knowledge of the delivery or financing of hospital services."

95. *Id.* § 34 requires that nonprovider members of the Council be persons "who have demonstrated experience in the field of consumer advocacy and who have no financial interest in any provider of services whose rates of reimbursement are determined by the commission."

96. For example, in fiscal year 1976 (July 1, 1975 - June 30, 1976), the RSC issued 39 regulations, including amendments and emergency regulations. COMMONWEALTH OF MASSACHUSETTS RATE SETTING COMMISSION, ANNUAL REPORT FOR FISCAL YEAR 1976, at 62-65 (1977). In fiscal year 1977, the number was 14. COMMONWEALTH OF MASSACHUSETTS RATE SETTING COMMISSION, ANNUAL REPORT FOR FISCAL YEAR 1977, at 56-57 (1978).

that must be given due weight by the RSC in deciding on the content of Chapter 409 regulations.

3. Ten-Taxpayer Interventions

The right of ten-taxpayer groups to participate in the processing of DON applications has been invoked with some frequency. During the period January 1974 through June 1977, one or more ten-taxpayer groups participated in 63 of the 517 DON project applications, a participation rate of 12.2%.⁹⁷ Of the total number of projects processed during this period, 226 were based on hospital applications,⁹⁸ and of those, 29, or 12.8%, involved ten-taxpayer group participation.⁹⁹

A recent analysis of the Massachusetts DON experience concludes with respect to ten-taxpayer group interventions, that "more often than not ten-taxpayer groups are directly or indirectly convened, supported and organized by providers to support their own applications or by competing or potentially competing applicants."¹⁰⁰ One of the authors of this study, a former Commissioner of DPH, opined that "no more than half a dozen ten taxpayer groups could reasonably be conceived of as representing consumer and broad community interests"¹⁰¹ during the period he served as Commissioner.

Analysis of the participation of ten-taxpayer groups in all DON project applications (not only hospital applications) since 1974 suggests a more discrete classification of the groups.¹⁰² It appears that ten-taxpayer interventions fall into four primary categories:

(a) *Ad Hoc Groups*. Of the 260 ten-taxpayer groups participating in the period under study, 89, or 34.2%, were considered as falling into the ad hoc category. These are groups formed by individuals without evident institutional ties or financial involvement with the applicant or competing applicants. Generally, the position of such groups is negative: many were formed, for example, to oppose half-way houses or abortion clinics in their neighborhoods. Those groups intervening in

97. Bicknell & Van Wyck, *supra* note 24, at 57.

98. *Id.*

99. *Id.*

100. *Id.* at 54.

101. *Id.*

102. The analysis of ten-taxpayer interventions at the DPH proceedings level is based on an examination of DON files undertaken by Thomas Lewis, J.D., staff attorney at the Center for Law and Health Sciences, Boston University School of Law. The typology used in the text was devised by Mr. Lewis. A detailed report on Mr. Lewis' analysis of the ten-taxpayer group intervention in DPH proceedings is to appear in *The American Journal of Law and Medicine*.

DON applications for hospital projects evidenced concern about the impact on the local community of proposed major building projects.

These groups tend to evolve spontaneously with single issue concerns. Because of their genesis, they do not develop technical sophistication in the substance or law relating to DON and ordinarily are not able to develop and maintain positions that provide assistance to the DPH staff or the Public Health Council in arriving at decisions based on the application of general policies. They are not concerned with the broader policy objectives of the DPH or the DON process, although they may employ the terminology of cost containment to support their single issue objectives.

The ad hoc groups do, however, represent legitimate grass-root concerns and may be viewed as reflecting general community interests in particular applications. While, therefore, their participation in DON appears to be consistent with the original purpose of including ten-taxpayer group intervention rights in the statute,¹⁰³ ad hoc groups cannot be viewed as providing a natural constituency for the cost containment objectives of DON. Indeed, their support of the program's objectives is presumably no greater than the DPH's willingness to support their opinions about a particular project application.

(b) *Community Organizations.* These ten-taxpayer groups arise from already established community organizations and therefore approach the specific issues involved in a DON project application from the perspective of the parent group's broader community objectives. It is estimated that about 23 of the 260 ten-taxpayer group interventions, or 8.8%, during the period under study were in this category. Most of these groups, because of their on-going character, have acquired a degree of expertise in dealing with governmental agencies generally not possessed by ad hoc groups. Moreover, many have legal representation. Consequently, the points they raise tend to be tailored to the DON process. These groups also have sufficient sophistication to appreciate the necessity of developing arguments invoking issues of cost-effectiveness, adequacy of planning and avoidance of duplication of facilities or services. Ordinarily, such groups will play on the Public Health Council's emphasis on community participation by alleging inadequate consultation between the applicant and the group's parent organization. In a number of cases, this has led to a delay in the processing of the application pending such consultation.

103. See text accompanying note 66 *supra*.

It appears, however, that ten-taxpayer groups in this category may often use a DON application to support objectives unrelated to the purposes of the application itself. For example, a Community Action Program established a ten-taxpayer intervention in the application process of a local hospital seeking to purchase a radiotherapy simulator and to renovate its radiology unit. The group alleged inadequate consultation by the hospital with the community's poor and Hispanic populations. By virtue of the intervention, the group obtained the hospital's agreement to extend outreach programs to those populations, as well as to publicize the availability of free care pursuant to Hill-Burton program requirements. While the group's objectives were valuable, and certainly reflected the needs and desires of a significant segment of the local community, once these specific objectives were obtained, the group dropped its objections and endorsed the hospital's application.¹⁰⁴

Community organizations, then, have developed skills in using the available statutory machinery to further their specific objectives. Not only are these objectives not intended to effectuate any cost containment policies inherent in DON, but to the extent they involve efforts to extend hospital services, they may be cost-producing.¹⁰⁵ As noted above with respect to the ad hoc groups, the community organizations do reflect "grass-roots" and public interest concerns, but because of the specificity of their objectives in intervening in the DON process, they do not provide a natural constituency to further general support for the program.

(c) *Financially Self-Interested Groups.* A number of groups intervene because they have direct financial stakes in the outcome of the review process. If approval were to be granted, they would suffer an economic harm. Ordinarily, these groups retain counsel and invoke considerations of cost-effectiveness and health planning to further their point of view. Rarely do they make a clear and direct statement of their financial interest, but their interest is usually perceived during the course of the application process.¹⁰⁶ Only 5 of 260 interventions, or

104. See DPH DON files, Application of Salem Hospital, No. 6-2646, and intervention of North Shore Community Action Program. See also Application of Lawrence General Hospital, No. 3-2647, and intervention of ten-taxpayer group chaired by Isabel Melendez.

105. In Application of Salem Hospital, No. 6-2646, the Hospital agreed to develop community outreach programs. In Application of Lawrence General Hospital, the Hospital agreed to establish a primary care clinic for the community.

106. A rare example of an explicit statement of financial self-interest on the part of an intervening ten-taxpayer group occurred with respect to the application of the Massachusetts General Hospital to build an Ambulatory Care Center; No. 6-2434. Many MGH physicians, who would

1.9%, during the period of the study, can reliably be categorized as involving financially self-interested groups.

(d) *Institutional "Front" Groups.* While it is difficult precisely to identify them as such, a number of groups appear to be fostered by the applicant institution specifically for purposes of supporting the application. When the subject matter of the application has no direct impact on the delivery of health care, for example, a request to acquire new research equipment, it may be presumed that intervening groups have been developed by the institution. In at least one case, a ten-taxpayer group used stationery that bore the name of the hospital whose application it was supporting.¹⁰⁷ For the period under study, 142 of the 260 interventions, or 54.6%, have been, somewhat arbitrarily, included within this category. Of the 142, however, 135, or 52% of all ten-taxpayer interventions, were by groups formed to support a single project, a proposed parking garage.¹⁰⁸

A review of the categorization and intervention objectives of ten-taxpayer groups suggests that they have been used largely to pursue particular community or local interests. Only rarely, if at all, have they attempted to further a general public interest in facility planning or cost containment. Because of the defined interest for which each intervenes, none of the categories of the ten-taxpayer groups represents a stable constituency available to the DPH in support of general program objectives, nor is any one of them therefore likely to have an impact on the broad goals or structure of DON, as opposed to the impact they can be expected to have on features of outcomes of specific applications. While, therefore, the perceived statutory objective of an enhanced "consumer" or "public" role¹⁰⁹ has been served by the availability of this mechanism, it appears to have had only a marginal impact on attaining general DON program objectives. As with participation in RSC public hearings, one of the reasons for less informed and con-

move into the proposed facility if constructed, were renting office space from an adjoining office and residential complex, the Charles River Park. The developer of the Park formed an intervening group, the Charles River Park Group. DPH's file on the application contains a letter of October 2, 1975 from the Group's attorney, who stated that "Charles River Park first became involved . . . out of substantial concerns for . . . loss of tenants from its professional office space." The Group, however, argued against the application on the basis of cost-effectiveness.

107. See DPH DON files, Intervention of Chelsea-Revere-East Boston-Winthrop Task Force, George Tyson, Chairman, in Application of Massachusetts General Hospital-Chelsea Health Center, No. 4-2657.

108. See DPH DON files, Application of Winchester Hospital, No. 3-2548. The transcript of the PHC meeting on this application, held February 24, 1976, noted that there were 135 groups intervening in support, but no addresses were provided.

109. See text accompanying notes 66 & 103 *supra*.

structive use of the ten-taxpayer interventions may derive from the availability of other mechanisms to provide DPH with more "expert" information, specifically the statutory right of participation by HSAs.¹¹⁰ Although no systematic study has yet been undertaken of the role of HSAs in the DON process in Massachusetts, one can reasonably speculate that many of the persons technically knowledgeable about the operations and objectives of the DON program, and sympathetic to its health planning and system restructuring goals, are likely to participate in the HSA review and comment process.

B. Political Opposition to Cost Containment Programs

Another method for determining whether provisions for public participation have produced general support for the objectives of DON and Chapter 409 involves consideration of the political opposition to the programs, that is, the extent to which such political opposition has developed, and its effectiveness in undercutting program objectives or decisions. While political opposition may take many forms, one of the most dramatic and most likely to be effective is a legislative effort to modify or override the program. When opposition reaches the level of affirmative legislative action to intervene, it may be presumed that disaffection with the program is extensive and that the program has not been able to develop countervailing political support. Analysis of legislative responses to the cost containment programs reveals clear differences between DON and Chapter 409.

The original DON legislation in Massachusetts derived from competing bills initially submitted by the governor and the Massachusetts Hospital Association.¹¹¹ At a point in the legislative process when it was felt that no bill would be enacted, however, a legislative committee produced its own version and ushered it to enactment as an emergency act.¹¹² A special legislative committee was then authorized to develop permanent legislation, and the DON bill finally enacted was almost entirely a product of that committee.¹¹³ Thus, both the decision to en-

110. See MASS. ANN. LAWS ch. 111, §§ 25C, E, G (Law. Co-op 1975).

111. See Commonwealth of Massachusetts, General Court, S. Docs. 1016 and 1453; H. Doc. 6125 (1971). See also Interim Report of the Joint Special Committee, *supra* note 22, at 3.

112. Law of Nov. 15, 1971, ch. 1080, 1971 Mass. Acts 1074. See Interim Report of the Joint Special Committee, *supra* note 22, at 3.

113. See generally Interim Report of the Joint Special Committee, *supra* note 22. Certain amendments were added to the Committee's proposal by the House and some were incorporated into the final Conference Committee version of the bill, which became Law of July 18, 1972, ch. 776, 1972 Mass. Acts 721. The amendments, however, did not go to the scope of the program, but

act a DON program and the structure of the program may be considered results of legislative, not executive or nongovernmental, initiative. It would therefore be reasonable to expect strong legislative support for the program.

This initial legislative support for the program did not, however, prevent the legislature on five occasions through the 1977 session from passing special bills for the purpose of overriding DPH decisions unfavorable to applicant hospitals. All five bills were vetoed by the governor, but all but one of the vetoes were overridden.¹¹⁴ Three of the bills ultimately enacted over the governor's veto affected relatively small institutions with strong community ties.¹¹⁵ Indeed, two of the three were municipally owned.¹¹⁶ It may be inferred that in all three cases it was a matter of political significance to the local representatives and senators that the affected hospital be supported, and that members of the legislature responded to this situation of political necessity with empathy. The fourth bill enacted over the governor's veto supported a Catholic institution, was endorsed by the Archdiocese, and was, not surprisingly, approved by a strongly Catholic legislature.

The only one of these bills not ultimately enacted related to the New England Baptist Hospital, a teaching hospital in Boston with no particularly strong ties to the local community. The proposed project was also the largest of the five in dollar terms. The absence of an organized constituency in the community to support the hospital, coupled with the magnitude of the project, permitted discussion to focus primarily on the cost implication of the special bill, not on community pride or other such factors.¹¹⁷

The validity of these statutory overrides of specific DON decisions by DPH was the subject of an action for declaratory judgment brought

related primarily to the DPH's capacity to assess application fees, the organizational structure of the Public Health Council, and the scope of review of the Health Facilities Appeals Board.

114. See Law of Oct. 17, 1973, ch. 923, 1973 Mass. Acts 935 (Bessie M. Burke Memorial Hospital); Law of Nov. 19, 1973, ch. 1053, 1973 Mass. Acts 1092 (Winchendon Hospital); Law of Nov. 9, 1977, ch. 721, 1977 Mass. Acts 873 (Amesbury Hospital); Law of Jan. 3, 1978, ch. 907, 1977 Mass. Acts 1262 (St. John of God Hospital); House Doc. 2960 (1977) (New England Baptist Hospital) (passed by both Houses but vetoed by Governor; veto sustained). See also Law of July 22, 1974, ch. 583, 1974 Mass. Acts 561 (Bessie M. Burke Memorial Hospital).

115. The institutions affected were Bessie M. Burke Memorial Hospital, Winchendon Hospital and Amesbury Hospital.

116. The institutions were Bessie M. Burke Memorial Hospital (Lawrence) and Amesbury Hospital (Amesbury).

117. See BOSTON GLOBE, Jan. 31, 1979, at 1, col. 1; *id.*, Jan. 9, 1978, at 12, col. 1; *id.*, Dec. 18, 1977, at 6, col. 1 (criticizing special bills, particularly one approving a \$30 million project for the New England Baptist Hospital, for undermining the state's cost control efforts).

by the Commissioner of Public Health. In that suit, *Commissioner of Public Health v. Bessie M. Burke Memorial Hospital*,¹¹⁸ the Commissioner alleged that the legislative actions constituted violations of articles 10 and 30 of the Declaration of Rights of the Massachusetts Constitution.¹¹⁹ The Supreme Judicial Court of Massachusetts ultimately upheld the legislative actions. With respect to the article 10 challenge, the court noted that earlier construction of the relevant constitutional language established the proposition that "the Legislature has no power to suspend the operation of a general law in favor of an individual,"¹²⁰ although it was evident that the court "'has often upheld special legislation.'"¹²¹ The court resolved this apparent conflict by interpreting article 10's proscription to apply only to situations in which benefits to the person singled out were

accompanied by corresponding injury to another person who can be definitely pointed to. . . . [A]rt. 10 appears not to forbid a special or private act which, while assisting an individual, does not by its operation diminish or defeat an existing property interest of any other individual, or do other injury to him.¹²²

The court upheld the special acts "because they [were] not shown to do injury to the interest of any individual or entity."¹²³ Perhaps recognizing the implications of its decision under the circumstances, the court chose not to give weight to the policies underlying the original departmental actions:

There is a sense in which excessive or misguided construction and subsequent inefficient utilization of health care facilities may cast needless expense on the members of the public who foot the bill in the long run, and other adverse consequences to the public can be imagined, but these results, if they should eventuate, are not specific harms to identifiable persons with which art. 10 is concerned.¹²⁴

The court left open the possibility that, if competitive applicants were disadvantaged by such special acts, then article 10's proscription could be activated. Apparently only under that circumstance could the added societal cost associated with unneeded construction rise to the level of a legally cognizable injury.

There is an irony here, some of whose significance is explored in a

118. 366 Mass. 734, 323 N.E.2d 309 (1975).

119. MASS. CONST. arts. 10, 30.

120. 366 Mass. at 742, 323 N.E.2d at 314.

121. *Id.*

122. *Id.* at 743, 323 N.E.2d at 314.

123. *Id.* at 744, 323 N.E.2d at 315.

124. *Id.* at 744-45, 323 N.E.2d at 315.

different context below.¹²⁵ Health insurance and governmental benefit programs were developed primarily to insulate citizens from the direct impact of hospital costs by spreading that financial burden across society through taxes and insurance. Yet, from the court's perspective, the availability of such risk spreading precludes otherwise appropriate parties from overturning special interest legislation that has the effect of increasing the overall cost burden to society. Arguably, if the citizens of the hospitals' service areas were still obliged to pay directly for their hospital care, instead of having the costs covered by insurance or governmental benefit programs, and it could be demonstrated that additional hospital investment increased the price of those services, then the requisite "harm to identifiable persons" would be established.

The court's analysis of the separation of powers issue under article 30 was substantially identical to its interpretation of article 10.

The substantial question is whether the legislative enactment itself which dictates a given result involves an improper intrusion on the functions of another branch. This is a problem to be examined on the facts, and seems to us to turn at least in civil matters on whether that enactment infringes on proprietary rights or does other specific injury, so that the issue here is much like that under art. 10.¹²⁶

In upholding the special acts, the court asserted its neutrality on the knotty question of the legitimacy of decisions rendered by DPH, but implied the propriety of using the legislature as a means of establishing "equity" in the administration of the DON program.

It is not for us to indicate a judgment as to whether a course such as that taken by the Legislature . . . is merely a conspicuous invitation to log rolling *or, on the contrary, an understandable and even necessary means of introducing an occasional equity into a general statutory scheme* It is enough to say that legislative choices that were made in the present case cannot be assumed by us on the present record to have been against "the good and welfare."¹²⁷

Following the 1977 session, the Massachusetts Legislature has continued to enact bills overriding DON decisions rendered by the DPH. As of September 1979, a number of such bills are awaiting gubernatorial action. While the DPH generally has opposed such override legislation, its main line of response has entailed the institution of procedural reforms of the DON process itself that served to deflect dissatisfaction with substantive decisions made by the DPH. Its theory

125. See text accompanying notes 178-199 *infra*.

126. 366 Mass. at 746, 323 N.E.2d at 316.

127. *Id.* at 750, 323 N.E.2d at 318 (emphasis added).

may be that political opposition to the program resulted not from opposition to the objectives of the program but from unhappiness about the length of time it took the DPH to process a project to conclusion and to reach a decision, and the uncertainty on the part of an applicant about the standards and criteria by which its proposed project could be evaluated. The inference is that it was believed that improved procedures and procedural rules could deflect political attacks on the program.

Acting on this presumed perception, both the DPH and the legislature initiated efforts to improve the DON process. Following enactment of the 1973 special bills, the DPH developed and promulgated amendments to the DON regulations "intended to improve the responsiveness of the process, to speed the processing of routine applications as well as making more explicit the criteria to be used by the Public Health Council in approving or denying applications."¹²⁸ In 1977, at the time the second group of special acts were under discussion, general amendments to the DON statute were adopted, requiring, for example, a shortened time period to process applications and mandating that applications be judged according to pre-established standards and criteria.¹²⁹ At the same time, efforts were undertaken to develop more explicit criteria to be employed in DON reviews.¹³⁰

The 1977 amendments were, as indicated, predominantly in the nature of procedural reforms. With one exception they cannot be easily construed as attacks on the integrity of the objectives of the underlying regulatory program, although they did place a premium on an efficient processing of applications by the DPH.¹³¹ The one exception related to the exemption from the DON program of certain research

128. See Bicknell & Van Wyck, *supra* note 24, at 11. See also Bicknell & Walsh, *Certification-of-Need: The Massachusetts Experience*, 292 NEW ENGLAND J. MED. 1054, 1059-1060 (1975).

129. Law of Jan. 9, 1978, ch. 945, 1977 Mass. Acts 1363 (codified at MASS. STAT. ANN. ch. 6A, § 35; *id.* ch. 111, §§ 25B, 25C, 25F, 25H (Law. Co-op Cum. Supp. 1978)).

130. See Mass. DON Regs., *supra* note 29, at pts. 60-65.

131. For example, the statutes now provide that DPH shall

approve or disapprove in whole or in part . . . [an] application for a determination of need within eight months after filing with the department; provided that the department may, on one occasion only, delay such action for up to two months after the applicant has provided information which the department reasonably has requested during such eight month period. Applications remanded to the department [by the HFAB under MASS. ANN. LAWS ch. 111, § 25E (Law. Co-op 1975)] shall be acted upon . . . within the same time limits. . . . Any application which has not been acted upon by the department within such time limits shall be deemed to have been approved.

MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op Cum. Supp. 1978). By contrast, the section originally provided that DPH "shall approve or disapprove, in whole or in part, or otherwise act upon every such application in a timely manner, but in any event within one hundred and twenty days after filing." Law of July 18, 1972, ch. 776, § 3, 1972 Mass. Acts 724 (emphasis added).

and teaching projects undertaken by hospitals.¹³² There too, though, the legislature appears to have made an effort to retain the cost containment objectives of the basic program by excluding from the exemption research and teaching programs whose costs would have an impact on patient care charges.¹³³

The efforts at procedural reform, as noted earlier, have not precluded further legislative overrides. The reform strategy may have failed, in part, because of the change of administration in Massachusetts in January 1979, and indications that the new governor would take a strong anti-regulatory stance.

Administration of the Chapter 409 program, unlike that of DON, has been relatively free of political controversy, at least as measured by legislative opposition.¹³⁴ It is instructive to speculate on why this is so. At least two factors may help account for the differences in reaction: the capacity of the RSC to employ a "formula" approach to implementing Chapter 409, and the gradualist or incrementalist philosophy embodied in the Chapter 409 statute. Each of these factors is described briefly below.

1. The Use of a Formula Approach To Ratesetting

The regulatory approach taken by the RSC involves two characteristics. First, it has been limited, at least to date, to relatively traditional cost analysis and does not attempt directly in the review process to incorporate less quantifiable considerations, such as quality or need. From this follows the second characteristic, which is the system's capacity to reduce operating principles used for developing allowable costs, revenues and charges, to definitional or mathematical formulae applied to historic and budgeted cost data.¹³⁵ The regulations governing the system define elements of cost, identify factors to be recognized in permitting changes in the hospitals' cost structure, and

132. See MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op Cum. Supp. 1978).

133. *Id.* Among the conditions attached by the statute to permit an exemption from the required DON review for research and teaching purposes is the requirement that "the cost of such expenditure or change shall cause no increase in the total patient care charges of the [applicant] facility to the public . . . , as such charges shall be defined from time to time . . . [by the RSC under Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 529]." On the subject of this exemption, see Friedman, *Federal Preclusion of State Certificate-of-Need Exemptions for Research and Education Expenditures*, 4 AM. J. L. & MED. 91 (1978).

134. Organized opposition to Chapter 409 has taken the form of direct judicial challenge, not legislative amendment. See *Affiliated Hosps. Cent., Inc. v. Weiner*, No. 22824 (Suffolk Sup. Ct. 1978); *Affiliated Hosp. Cent., Inc. v. Weiner*, No. 19457 (Suffolk Sup. Ct. 1977).

135. For examples of the types of formulae employed, see Massachusetts Rate Setting Commission Regulation 114.1 C.M.R. § 8.00 (1978).

establish formulae for quantifying those factors in analyzing an individual hospital's experience.

An important feature of the formula approach is that it does not vest much discretion in individual staff members of the agency, or even in the Commissioners themselves, to vary the rules or make personal equitable judgments in individual cases. This is in contrast, for example, with budget negotiation systems in which there is an absence of explicitly established rules and many discretionary decisions are made during the review of a particular budget.¹³⁶ On the other hand, a formula approach may be unduly rigid and insensitive to genuine equitable needs arising in unique or unusual circumstances. The formula approach does, however, have a significant advantage in removing policy formulation from individualized and highly discretionary personal judgments and placing it at the point at which regulations incorporating the formulae are developed and promulgated. A number of benefits accrue to the RSC from this reliance on a rulemaking approach:

First, judicial review is ordinarily sought as an attack on the regulation, not on the specific application of the regulation. In defending itself, the RSC enjoys the presumption in favor of its action in implementing its statutory authority.¹³⁷ This posture contrasts with that of other ratesetting programs that rely on negotiations with hospitals and informal guidelines developed for application during the negotiation process.¹³⁸

Second, rules of general applicability are developed with sufficient specificity to minimize agency discretion and are then applied consistently to all providers. The result is that hospitals generally feel that they have been treated fairly, that is, consistently, in the process. This "perception of fairness" may be a prerequisite for avoiding substantive as well procedural attacks on a regulatory program.

Finally, reliance on rulemaking moves complaints about the process away from individual decisions to the more distant, technical, and abstract rulemaking process itself. Use of rulemaking and the develop-

136. For a description and discussion of these approaches, see *Danbury Hosp. v. Commission on Hosps. and Health Care*, No. 18958 (Ct. of Common Pleas, Fairfield County, Conn. 1978); *New Britain Gen. Hosp. v. Commission on Hosps. and Health Care*, No. 13 24 86-1 (Ct. of Common Pleas, Hartford County, Conn. 1977); *Franklin Square Hosp. v. Health Serv. Cost Review Comm'n*, No. 82047 (Baltimore County Ct., Md. 1975).

137. See *Affiliated Hosps. Cent., Inc. v. Weiner*, No. 22824, at 24-25 (Suffolk Sup. Ct. 1978).

138. See *Danbury Hosp. v. Commission on Hosps. and Health Care*, No. 18958 (Ct. of Common Pleas, Fairfield County, Conn. 1978); *New Britain Gen. Hosp. v. Commission on Hosps. and Health Care*, No. 13 24 86-1 (Ct. of Common Pleas, Hartford County, Conn. 1977); *Franklin Square Hosp. v. Health Serv. Cost Review Comm'n*, No. 82047 (Baltimore County Ct., Md. 1975).

ment of technically complex formulae make it difficult to identify an effective time at which to mobilize opposition to the program. To the extent that the rules are technical, most potential opponents would find it difficult to build support on the basis of dimly perceived policy implications that are being attacked. To the extent explicit rules are applied consistently, opponents cannot rely on inequitable administration as a political lever for change or as a legal argument.

In contrast to the Chapter 409 program, the DON program has not enjoyed reliance on technical formulae and rulemaking. The enabling act contains language that could permit reduction of rules governing decisionmaking to mathematical constructs,¹³⁹ but until relatively recently such an effort has not been made on a significant scale.¹⁴⁰ In ordinary language, "need" is a highly subjective concept that must be analyzed by examining a multiplicity of factors. The RSC limits itself to cost analysis, whereas the DPH cannot so restrict its scope of inquiry but must of necessity venture into a variety of subjective or discretionary areas of evaluation.¹⁴¹ Some but not all of the relevant factors can be reduced to mathematical precision for purposes of evaluation. Even relatively precise guidelines, however, will often leave much discretion with the agency concerning their application in specific circumstances. In such situations, if the agency does not articulate clearly the reasons for a particular decision, or fails to develop a set of "common law" principles enabling it to identify consistent lines among different outcomes,¹⁴² an individual decision may be challenged as unfair, inequitable or inconsistent with treatment provided to similar applicants. Further, in the absence of reliance on rulemaking, policies or interpretations may change from one application to another, but the agency may have no formal capacity to notify applicants of the changes. This

139. See MASS. ANN. LAWS ch. 111, § 25C (Law. Co-op 1975).

140. See text accompanying notes 43 & 129 *supra*.

141. See, e.g., Bachman, *Health Planning—The Next Step*, 3 HEALTH L. PROJECT BULL. 1 (1978); Bicknell & Walsh, *supra* note 128, at 1059; Bovbjerg, *Problems and Prospects for Health Planning: The Importance of Incentives, Standards, and Procedures in Certificate of Need*, 1978 UTAH L. REV. 83, 90-97. See also Schonbrun, *Making Certificate of Need Work*, this Symposium, at text accompanying notes 27 & 28, 93-101.

142. The DPH staff has, on a number of occasions, considered undertaking a detailed analysis of Public Health Council minutes and records to determine the operative rules and factors that actually structured the decisions on DON applications and developing, in effect, a common law approach toward applicable rules. Conversations with David Rosenberg, DPH General Counsel, 1973, and with Jacob Getson, Director, Office of State Health Planning, DPH, 1979. Such an approach would constitute an alternative or supplement to the standards and criteria development process described in the text accompanying notes 83 & 84 *supra*.

may enhance the feeling of unfairness on the part of the subject hospitals.

The subjectivity of the definition of "need" complicates the political life of a DON agency in another respect. DON applications are ordinarily the product of an internal decisionmaking process in which the hospital itself proceeds to identify and respond to community need. When an application is filed, the regulatory agency must reassess that need determination process and place it in the context of its statewide policies and objectives, rather than merely those of the institution or even the local community. Consequently, very different perceptions of "need" may be at play, and an adverse regulatory decision may not be accepted when the local community feels that the individual hospital actually does have an accurate perception of its "need."

2. Gradualism

Both DON and ratesetting are relatively new regulatory programs. The sophistication of the analytic techniques available to support their decisions is still in an early state of development.¹⁴³ When a regulatory program must rely on an evolving technical state of the art, a number of strategic options are available: regulatory authority may be withheld until the analytic support for reasoned and consistent decisions is available; general regulatory authority may be established, but certain classes of decisions may be precluded pending further analytic developments; or the inadequacy of the underlying techniques may be ignored, so that an agency may be required to render regulatory decisions even absent adequate or generally accepted technical grounds.¹⁴⁴

DON in Massachusetts, at least until the 1977 amendments,¹⁴⁵ followed the third option. Although the DPH was given extensive DON authority in the 1971 and 1972 enactments, at the time very little in the way of standards and criteria for evaluating need had been developed,

143. HEW is, for example, currently funding major evaluation studies of certificate of need and ratesetting programs in a number of states. The certificate of need study is being undertaken by Urban Systems Planning and Engineering, Inc., Cambridge, Mass., and that of ratesetting programs by Abt Associates, Inc., Cambridge, Mass.

144. See Weiner, *State Regulation and Health Care Technology*, in *TECHNOLOGY AND THE QUALITY OF HEALTH CARE* 218-221 (Egdahl & Gertman eds. 1978). An excellent example of the difficulties posed for reviewing courts where agencies make decisions under the circumstances described in the text appears in the various opinions and statements regarding the appropriate scope and standards for judicial review by members of the United States Court of Appeals for the District of Columbia Circuit in *Ethyl Corp. v. EPA*, 541 F.2d 1 (D.C. Cir. 1976), *cert. denied*, 426 U.S. 941 (1976).

145. See text accompanying notes 131 & 132 *supra*.

and very little analytical work had been undertaken to develop standards and criteria that could generally be accepted as valid for implementation in a DON program. Indeed, the major incentive for developing such standards and criteria did not occur until 1975, with enactment of the National Health Planning and Resources Development Act.¹⁴⁶ Thus, much of the history of the DON program after 1971, and especially after 1975, entailed efforts to develop specific analytic techniques and an effective health planning process to provide a basis of support for DON decisions. Absent these efforts, little ground existed for explaining individual decisions in a broader context, for identifying consistencies in decisions, or for acceptance of the DPH's "expertise" in administering the program.

In contrast, the drafters of Chapter 409 recognized the evolutionary nature of ratesetting and structured the statute in line with that recognition. The approach taken was not a blanket authorization to the RSC to undertake charge or budget control. Such an approach might have generated unrealistic expectations concerning the RSC's capacity to administer a fully effective program. Had such an expectation forced the RSC to initiate a more ambitious program than that of which it was technically capable, the program would likely have proved a disaster.

Instead of a sudden and sweeping mandate, Chapter 409 reflected a philosophy of starting with what was known and building gradually. Techniques for the control of rates of increase, such as inflation projections and volume adjustment formulae, were familiar to most Massachusetts hospitals through their participating agreement with Blue Cross,¹⁴⁷ and through some of the conceptual developments in the later stages of the federal economic stabilization program.¹⁴⁸ The hospitals were also used to working with Medicare's definition of cost.¹⁴⁹ Thus, Chapter 409 relied in its first years of implementation on a definition of "total patient care costs" tied to Medicare's definition of allowable cost categories,¹⁵⁰ and on analytic techniques already familiar in the

146. National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (1975) (codified at 42 U.S.C. §§ 300k, 300t (1976)).

147. See Blue Cross of Massachusetts, Inc., Participating Hospital Agreement HA-25-TH, art. IV, § 4, at 18-22 (1973).

148. See 6 C.F.R. §§ 150.705-.706 (1974).

149. Medicare's definitions of cost allowable for reimbursement under the program are set forth at 42 C.F.R. §§ 405.401-.488 (1977).

150. Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 522. See also *Affiliated Hosps. Cent., Inc. v. Weiner*, No. 22824, at 22-31 (Suffolk Sup. Ct. 1978).

state.¹⁵¹ The statute identified specific gaps in the system, such as the eventual inadequacy of the Medicare definition in the context of a budget control program¹⁵² and the need to incorporate analyses of current or base year cost levels through techniques of comparing the costs of like institutions.¹⁵³

Finally, Chapter 409 required the RSC to address these gaps over a period sufficiently long to permit the development of viable analytical approaches, which were then to be incorporated into the control system. Chapter 409 became effective on October 15, 1976. The RSC was directed to revise the definition of "total patient care cost" by October 1, 1978,¹⁵⁴ and to develop a methodology for grouping hospitals for comparative purposes by October 1, 1979.¹⁵⁵ Behind this approach was the desire to enhance the agency's competence to handle more sophisticated techniques before they were actually employed in a regulatory decisionmaking process.

Other examples of this gradualist approach appeared in specific administrative decisions made by the agency during the early phases of implementation. These included the decision to continue use of traditional hospital charge schedules instead of requiring a standard payment unit.¹⁵⁶ A similar philosophy underlay the RSC's sensitivity to the appropriate allocation of decisionmaking responsibilities between itself as a public agency and the hospital as a private institution. Thus, for example, principal emphasis in the Chapter 409 program is on development of a "bottom line" amount representing maximum allowable revenue available to the hospital annually.¹⁵⁷ Expenditure of this allowable revenue is not rigidly allocated to individual departments or line items. In effect, the hospital management was expected to make its

151. For example, MASS. STAT. ANN. ch. 6A, § 37 (Law. Co-op Cum. Supp. 1978) allows the RSC to approve a modification in charge proposed by a hospital if "the increase proposed is consistent with the rate of inflation in the economy generally, as measured by a composite price index to be specified in such regulations [of the RSC] and based, to the extent practicable, on any index approved by the commission and contained in [Blue Cross agreements approved by the RSC under *id.* ch. 176A, § 5 (Law. Co-op 1977)]."

152. See Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Laws 522.

153. See MASS. STAT. ANN. ch. 6A, § 40 (Law. Co-op Cum. Supp. 1978).

154. Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Laws 522.

155. MASS. STAT. ANN. ch. 6A, § 40 (Law Co-op Cum. Supp. 1978).

156. See Massachusetts Rate Setting Commission Regulation, 14 C.H.S.R. § 4 (1975).

157. Massachusetts law provides that the RSC "shall approve or disapprove in whole or in part *only* the total patient care costs and total patient care charges projected by the applicant or filing hospital." MASS. ANN. LAWS ch. 6A, § 40 (Law. Co-op Cum. Supp. 1978) (emphasis added). The implication is that approval goes to the total figures and not to any departmental breakdown that may be used in constructing the aggregate figures. "Total patient care costs" and "total patient care charges" are defined in Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 522.

own decisions concerning the use of available financial resources, so long as the "bottom line" was not exceeded.

This gradualist approach also meant, of course, that the system would become increasingly rigorous over time, with its full potential impact being deferred for some years. It may be likely, therefore, that political opposition to the program has been deferred, with hospitals adopting a wait and see attitude while the additional elements of the program are developing. And, indeed, some of the RSC's approaches to satisfying the statutory mandate have already generated significant concern and opposition from hospitals.¹⁵⁸ With the full operation of the program scheduled for October 1, 1979, (with the addition of the technique for comparing hospitals) bills have now been introduced into the 1979 session of the legislature, supported by the Hospital Association or other hospital representatives, to modify or defer portions of the Chapter 409 enabling act.¹⁵⁹ The current session of the legislature may provide some evidence on the question whether, despite the different approaches to decisionmaking taken by DON and Chapter 409, they may nonetheless both be equally subject to significant and effective political opposition.

158. For example, in March 1978, the RSC circulated publicly an issues paper concerning the definition of "reasonable financial requirements" that it was to adopt by October 1, 1978, pursuant to Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 529. See *Financial Requirements Under Chapter 409—Background and Issues*. The paper was presented at a series of public hearings held for hospital trustees, administrators and financial staffs in March and April of 1978. Among other matters, the paper dealt with possible uses of hospital restricted and unrestricted income and charitable contributions in the budget review and approval process. The hospital response to suggestions in the paper that nonpatient sources of revenue might be used in defining "reasonable financial requirements" was strongly negative. See, e.g., *MASSACHUSETTS HOSPITAL ASSOCIATION, THE ROLE OF RATE SETTING, FINANCIAL REQUIREMENTS, AND STATE HEALTH POLICY IN YOUR HOSPITAL* (1978); *NEW ENGLAND ASSOCIATION FOR HOSPITAL DEVELOPMENT, THE ROLE OF PHILANTHROPY IN MASSACHUSETTS HOSPITALS: A SPECIAL REPORT TO THE RATE SETTING COMMISSION, COMMONWEALTH OF MASSACHUSETTS* (1979).

H. No. 3466, which was introduced into the 1979 session of the Massachusetts legislature, proposes to preclude use by the RSC of unrestricted and restricted income in calculating charges or approving budgets. The Joint Legislative Committee on Health Care has voted approval of the bill.

159. H. No. 3466 (1979) proposes to preclude use by the RSC of unrestricted and restricted income in calculating charges or approving budgets. See note 158 *supra*. H. No. 3478 (1979) would defer imposition by the RSC of uniform reporting requirements pending federal development of uniform reporting regulations. H. No. 3479 (1979) would delay the requirement of Chapter 409 that the RSC develop a methodology for grouping hospitals until uniform reporting requirements are established. The Joint Legislative Committee on Health Care, in April 1979, voted to support H. No. 3466 and to reject H. No. 3478 and H. No. 3479.

IV. FACTORS SUGGESTING LACK OF POLITICAL SUPPORT FOR COST CONTAINMENT

A. Introduction

The analyses undertaken in the preceding section suggest some tentative conclusions. First, there may be only limited circumstances in which the capacity for general public participation in the cost containment regulatory process may be effective. Such circumstances involve a combination of two elements: a structured opportunity for diverse interest groups to participate and possession by the group of a relatively high level of technical expertise. Thus, the analysis suggests that the RSC Advisory Council has not been successful, either in changing RSC positions or in providing support for its program objectives, whereas the Hospital Policy Review Board has been an effective participant.

Second, the availability of extensive opportunities for public participation in agency proceedings is not correlated with effective political support for agency programs. Despite substantial opportunities for general public and interest group involvement in the review of DON applications, the program was not able to withstand political attacks culminating in legislative overrides of specific decisions.¹⁶⁰ While the RSC has not yet been subject to equivalent political difficulties, it is not yet certain whether similar openness in the Chapter 409 process will provide useful support to the RSC in the face of intensified hospital opposition. Further, the possibility for participation in such proceedings, except perhaps when they are highly structured, as in the case of the Hospital Policy Review Board, has not provided a mechanism for the regulatory agencies to undertake public education to develop support.

Third, other procedural issues may be more significant in determining the effectiveness of political opposition to the regulatory program than the question of who may participate in the agency's decisionmaking process. Processing time, clarity of the "rules of the game," consistency in decisionmaking and confidence in the competence of the decisionmaker may all be more conducive to providing political support for the program, or at least neutralizing political opposition, than public participation in agency processes.

An evaluation of the relationship between public participation and

160. See text accompanying notes 114-127 *supra*.

political support, however, must consider the nature of the constituency groups likely to be interested in participating in a hospital cost containment agency's processes, and the political position of such groups with respect to the agency's objectives. An implicit assumption of the foregoing analysis has been that there were sufficient nonprovider interest groups supportive of the agency's reformist objectives to permit the conclusion that the agency's objectives reflected the "public interest." But if, as it appears, the role of public participation has had relatively little impact on the political status of the particular program, perhaps the phenomenon is due to the very nature of the constituencies themselves. In short, is there any constituency group likely to provide continuing and strong support to the cost containment objectives of the DPH in administering DON or the RSC in administering Chapter 409? One could infer from the preceding analysis that a group's support for a cost containment program is a function of its immediate and particular interests, not necessarily reflecting general support of program objectives, and that cost containment is not generally viewed by the public at large as a significant policy objective. Therefore, the willingness of any particular interest group to support general program objectives will last only so long as and to the extent that those objectives directly benefit the relevant interest group. While such a conclusion is hardly surprising, it does nonetheless suggest the tenuous nature of political support for cost containment objectives and the need for the regulatory agencies to develop clear evidence and statements concerning the relationship between their goals and the particular interests of affected groups.

Estimating potential public support for cost containment becomes increasingly important as the Massachusetts regulatory agencies attempt, on the basis of ambiguous statutory authority, to move beyond the explicit statutory authorizations of DON and Chapter 409 to encourage or require mergers or closures of services and institutions.

B. Potential Constituencies for Cost Containment

A persistent question is why should a regulatory agency attempting to achieve cost containment objectives in the hospital field have difficulty developing broad public support among nonhospital interests? A number of organized constituency groups emerge as logical supporters of cost containment objectives: government itself, particu-

larly as a major purchaser of hospital services through Medicare¹⁶¹ and Medicaid¹⁶²; insurers, who must translate hospital costs into insurance premiums; business and labor, as groups primarily responsible for purchasing insurance to provide financial protection against the risks of hospitalization; and the elderly, who pay a certain portion of medical expenses out of pocket despite Medicare. While each of these groups represents potential supporters of cost containment, the capacity of each to provide effective and consistent political support to the cost containment objectives of regulatory agencies is affected by certain basic structural characteristics of the hospital delivery system — specifically the role of government, the role of insurance and the status of hospitals themselves. Each of these characteristics, and its impact on potential constituencies for cost containment, is explored in the following sections.

1. The Role of Government

The federal and state governments perform multiple functions in the hospital delivery system. Of greatest significance for purposes of this analysis are their responsibilities for purchasing and regulating services.¹⁶³ Through Medicare and Medicaid, the financing of hospital services on behalf of defined populations is shared by both levels of government. The federal government has the greater fiscal obligation because of the structure of Medicare¹⁶⁴ and its cost sharing responsibilities under Medicaid.¹⁶⁵ State governments are more immediately and continuously faced with the costs of supporting Medicaid because they must annually appropriate the full amount necessary to operate the program, subject to reimbursement of a specified percentage from the federal government.¹⁶⁶ Aside from financial responsibility, state government has traditionally been the primary unit for regulating hospital services, a role reinforced by the National Health Planning and Re-

161. 42 U.S.C. § 1395F(b) (1976).

162. *Id.* § 1346 (1976).

163. Weiner, *supra* note 144, at 211-215.

164. The primary sources of payment for Medicare benefits are the Federal Hospital Trust Fund, established by § 1817 of the Social Security Act, 42 U.S.C. § 1395i (1976), and the Federal Supplementary Medical Insurance Trust Fund, established by § 1841 of the Social Security Act, 42 U.S.C. § 1395t (1976). Sources of revenue for the trust funds are payroll taxes and beneficiary premiums.

165. *Id.* § 1396b sets forth the provisions concerning the financial responsibility of the federal government for Medicaid.

166. *See, e.g.*, 44 Fed. Reg. 10,553 (1979) (setting forth the federal medical assistance percentage per state for the period October 1, 1979 through September 30, 1981).

sources Development Act.¹⁶⁷

At least in states with large Medicaid programs, such as New York and Massachusetts, the state's responsibility for financing hospital services has been a major determinant of the position of its executive on regulating the costs of those services. Both New York and Massachusetts originally undertook cost containment programs directly tied to their Medicaid responsibilities, and thus attempted regulation through the medium of financing.¹⁶⁸

But this approach may produce at least two potentially inequitable effects. The first effect may be an increased differential between Medicaid rates and rates paid by other purchasers for the same hospital services, with Medicaid paying less. This effect occurs because of the way in which the payment rates for hospital services are developed. In simplest terms, hospitals are paid on the basis of "cost" or "charges." Blue Cross, Medicare and Medicaid generally develop their payment rates on the basis of the cost figures of the particular hospital.¹⁶⁹ Yet the rates for all cost-based payors for the same services are not the same because of the different definitions of allowable cost that may be used in drawing up rates.¹⁷⁰ Thus, the Medicaid program may employ a restrictive definition to achieve cost containment objectives, whereas Blue Cross and Medicare may use a less restrictive approach. In such a circumstance, costs that are not recognized for Medicaid purposes are included in developing Blue Cross and Medicare rates. The latter rates will therefore be higher than Medicaid's. Further, the hospital's decision to incur costs that will not be reimbursed by Medicaid, but will be paid by Blue Cross and Medicare, will be a function of the number of patients covered by, and the proportion of hospital patient care revenue received from, the respective programs. If Medicaid accounts for only ten percent of hospital revenue, whereas Blue Cross and Medicare combined account for seventy-five percent, the hospital is likely not to structure its cost decisions based on Medicaid's principles, but rather to

167. 42 U.S.C. §§ 300k-300t (1976). The Act requires that states must adopt a certificate of need program satisfactory to the Secretary of HEW. *Id.* § 300m-2(a)(4)(B) (1976). The constitutionality of this provision was upheld in *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 98 S. Ct. 1597 (1978).

168. *Weiner*, *supra* note 25, at 15-21, 24-27, 27-28 n.74.

169. *See* MASS. ANN. LAWS ch. 176, § 5 (Law. Co-op 1977) (Blue Cross of Massachusetts); 42 U.S.C. § 1395f(b) (1976) (Medicare); *Id.* § 1396a(13)(d) (1976) (Medicaid).

170. For example, Massachusetts Medicaid and federal Medicare rates provide for straight-line, historical cost depreciation, but until recently Massachusetts Medicaid used 50 years as the standard building life, while Medicare uses 40. Massachusetts Blue Cross, on the other hand, uses price level depreciation. Chapter 409 allows recognition for bad debt and free care, while Massachusetts Medicaid does not. Law of Oct. 15, 1976, ch. 409, § 5, 1976 Mass. Acts 522.

accept a loss of only approximately ten percent of that portion of its cost not reimbursed by Medicaid.

A hospital's capacity to absorb this "Medicaid loss" is enhanced by its freedom to raise charges. Certain classes of purchasers, specifically commercial (non-Blue Cross) and self-pay patients, pay charges that hospitals in most states are free to establish on any basis whatsoever, whether or not cost-related.¹⁷¹ Under such circumstances hospitals are able to increase charges to offset in part the amount of the "Medicaid loss."

Thus, because of either the differences in definitions of allowable cost used by cost-based purchasers, or the capacity of hospitals to increase charges free of regulatory controls, efforts to use Medicaid to contain costs would produce differentials when Medicaid was paying less than other purchasers for identical hospital services.

While such a result may be acceptable from the state's perspective as a purchaser, it is troubling in the context of the state's general police power responsibilities to protect the public health and welfare. By regulating only Medicaid rates, and not overall costs or charges directly, the state is in effect increasing the price of hospital services to non-Medicaid patients for the benefit of its own program.

The second effect may be that hospital costs are not constrained at all. For example, under the terms of the Medicaid prospective formula employed in Massachusetts,¹⁷² when a particular year becomes the base year for the rate calculation, the full Medicaid allowable costs for that base period are recognized.¹⁷³ As a result, the prospective formula does not reduce the rate of increase in hospital costs, but merely defers the impact of past increases on Medicaid rates.¹⁷⁴

171. See Massachusetts Rate Setting Commission Regulation, 114.1 C.M.R. § 3.00 (1978).

172. *Id.* § 3.05(5), 3.07. Under the original prospective methodology adopted by the Massachusetts Rate Setting Commission to determine Medicaid rates for in-patient hospital services, the "base year" was the second year prior to the rate year. That is, for fiscal year 1975 rates, the base year was fiscal year 1973. See Massachusetts Rate Setting Commission Regulations 74-1 (1974), 74-26 (1974), 14 C.M.S.R. 3 (1975). Medicare allowable costs in the base year, with certain specified exceptions, were adjusted to develop rate year allowable costs. Effective January 1, 1978, that methodology was changed; although the second prior year continued to be defined as the base year, allowable base year costs were adjusted by using the third prior year's costs and projecting them forward to the base year before adjusting base year cost to develop rate year cost. The Medicare allowable costs in the third year prior to the rate year provide a basis for developing rate year rates. See generally Massachusetts Rate Setting Commission Regulation, 114.1 C.M.R. § 3.00 (1978).

173. See Testimony of Stephen M. Weiner, Chairman, Massachusetts Rate Setting Commission, before Joint Legislative Committee on Health Care, on H. 3160 (March 1976). See also Weiner, *supra* note 25, at 44 n.117.

174. See Message from Governor Michael S. Dukakis to The Honorable Senate and House of

Because of continuing increases in Medicaid expenditures, even with its prospective formula, the state administration in Massachusetts had the choice in 1975 of further modifying the rate formula, which would have had the effect of further increasing the differential between Medicaid and other rates, or shifting the basis for cost containment strategies from reliance on purchasing responsibilities to reliance on the general police power authority. This was the political origin of Chapter 409. The primary political support for the program came from the administration and from the legislative Ways and Means Committees, the members of which were concerned about Medicaid expenditures. They saw regulation of charges and control of hospital budgets as the means for effectively limiting Medicaid costs.¹⁷⁵ Although the general societal and economic benefits of such a program were also emphasized,¹⁷⁶ it seems unlikely that the program would have been enacted in the first place without the impetus of the Medicaid budget.

A similar development has been occurring at the federal level. Originally, federal cost containment efforts were tied to purchasing responsibilities.¹⁷⁷ But increases in federal obligations for Medicare and Medicaid moved the Carter Administration to endorse general revenue controls, not merely controls over revenues derived from federal sources.¹⁷⁸

It may be expected that the executive department's concern about its continuing responsibility for financing hospital care will make it particularly sensitive to the need for controlling the costs of that care and that it will continue active efforts to foster cost containment objectives. Such efforts will proceed from the dual motivation of police power concerns about the general public good and narrower budgetary concerns about the cost of government health care programs. Never-

Representatives, April 15, 1975, contained in H. No. 6092 (1975). Appendix C of the Governor's Message consisted of a proposal to freeze hospital charges until June 30, 1976, and initiated the legislative process producing Law of July 9, 1975, ch. 424, 1975 Mass. Acts 449. H. No. 6092 contained a series of bills intended to "bring the budget of the Department of Public Welfare under control." That Department is the responsible agency for administering the state Medicaid program. See MASS. ANN. LAWS ch. 118E (Law. Co-op 1975 & Cum. Supp. 1978). See also Stephen M. Weiner, Chairman, Massachusetts Rate Setting Commission, Testimony in Support of H. 6092, Appendix C, On Behalf of His Excellency, Governor Michael S. Dukakis, the Executive Office of Human Services, and the Massachusetts Rate Setting Commission, May 27, 1975, at 3-4 [hereinafter cited as Testimony in Support of H. 6092].

175. See Testimony in Support of H. 6092, *supra* note 174, at 3-4.

176. Weiner, *supra* note 25, at 28-36.

177. H.R. 6575, 95th Cong., 1st Sess. (1977); S. 1391, 95th Cong., 1st Sess. (1977).

178. For a discussion of the impact of Medicare and Medicaid on the market for health care services, see Posner, *Regulatory Aspects of National Health Insurance Plans*, 39 U. CHI. L. REV. 1, 2 (1971).

theless, because of the substantial purchasing responsibilities of government, it is likely that the cost containment initiatives will be viewed by affected interest groups as arising predominantly from budgetary concerns. As a purchaser, the executive department of government may be considered as no different from any other interest group acting in and around the hospital delivery system. Its pronouncements and attitudes will not be accorded any greater weight than those of other interests. If its position is not viewed as generally conducive to the public good, then, like any other interest group, it will still have to persuade other interests to support its objectives.

Under such circumstances, that a cost containment regulatory agency may be pursuing its objectives with the support of other executive agencies, including the chief executive, does not assure it of strong political support. Its political efficacy will be a function of the relative bargaining power between the executive and legislative branches, the role of the ways and means committees within the legislature (assuming they understand and support the link between cost containment and budget), and the identification by other interest groups with the executive's objectives. Political support for such an agency will still then depend in large measure on the willingness of other groups to support it. The availability of that support, specifically from nonprovider interest groups, is related to the second characteristic of the hospital delivery system—the role of insurance.

2. The Role of Insurance

Insurance is often credited with eliminating traditional market mechanisms in the hospital delivery system. To the extent that insurance insulates direct consumers of hospital services from the actual cost of those services, especially inpatient services, it removes price as a consideration in any consumer choice with respect to the quantity and location of hospital services. Probably more significantly, since demand for acute inpatient hospital services is usually generated by physicians rather than by the ultimate consumer, the availability of insurance has removed price as a factor in decisions by physicians about the type, quantity or location of such services to be provided patients. The direct price of a service, then, does not ordinarily function to allocate hospital resources in the way traditional supply and demand models presume.

Although the price of the particular service may no longer serve as a primary device of resource allocation, the price of insurance itself appears to be assuming that function. As the preceding section de-

scribed, the price of government "insurance," through Medicare and Medicaid, has generated cost containment efforts by the parties responsible for paying that price, the federal and state governments. Parallel efforts are beginning to occur in the private sector as well, in which the price of insurance is reflected not only in tax levies to support the governmental programs but in expenditures to pay the premiums necessary to provide for private (Blue Cross and commercial) insurance coverage. Increases in the cost of insurance generally reflect increases in the direct cost or price of the services purchased through insurance. In effect, the price of insurance is becoming a surrogate for the price of services in mobilizing "consumers" to exercise economic leverage to produce more favorable prices. In this case, however, the "consumer" is not the ultimate user of the hospital service, or even the physician prescribing the service, but the party who is financially responsible for paying for the insurance policy.

The principal interest groups affected by increases in insurance prices are employers, employees and the elderly.¹⁷⁹ A substantial proportion of Blue Cross and commercial health insurance is marketed through employer groups. In many cases, the employer will assume some portion of the premium involved in purchasing the insurance. The expense so incurred is allowable as a tax deduction under the Internal Revenue Code,¹⁸⁰ and is not treated as income to the employee.¹⁸¹ The balance of the premium expense is borne by employees, who may take some portion of the expense as a tax deduction.¹⁸² Increases in hospital costs will push up the cost of insurance to employers and employees, thereby making these groups potential supporters of cost containment programs.¹⁸³

The impact of the increasing cost of hospital care is also felt in the out-of-pocket expenditures of the elderly. Indeed, despite the advent of Medicare, actual out-of-pocket expenses incurred by the elderly for re-

179. The role of these nonprovider interests is specifically recognized in the composition of the Hospital Policy Review Board. See text accompanying notes 56 & 57 *supra*.

180. See I.R.C. § 162.

181. I.R.C. § 106. See generally Havighurst, *More on Regulation: A Reply to Stephen Weiner*, 4 AM. J. L. & MED. 243, 248 (1978).

182. I.R.C. § 213.

183. Both groups have been identified as potential sources of support for the efforts at obtaining charge and budget control legislation. Indeed, much of the effort undertaken by the Dukakis Administration in Massachusetts in its strategy that led to enactment of Act of Oct. 15, 1976, ch. 409, 1976 Mass. Laws 522, involved attempts to obtain public commitments from representatives of these two groups. (Material in personal files of the author.) A similar strategy has been undertaken by the Carter Administration nationally in an effort to secure enactment of its proposed Hospital Cost Containment Act.

ceiving medical services have increased since the mid-1960s.¹⁸⁴ Among the sources of this increase are increases in the amount of co-insurance for Medicare¹⁸⁵ and in the price of supplemental insurance purchased to cover Medicare co-insurance and services not provided under Medicare.

The economic effect of increases in the cost of coverage has placed pressures on the insurers themselves to implement strategies to contain that cost. Only two strategies appear available to them: reducing the level of benefits provided under any particular policy's coverage, either by eliminating coverage for certain services or by instituting or expanding co-insurance features, or seeking to contain increases in the underlying cost of the services purchased. The former strategy is a limited one: although there appear to have been occurrences of decreased coverage, there is continuing pressure, particularly from the larger unions, to increase the scope of benefits provided under group insurance arrangements and to oppose any increased use of co-insurance. Further, any decreases in the types of services covered would likely not be in the highest cost area of acute inpatient hospital services. Another factor militating against use of this strategy is the appearance of state statutes mandating certain kinds of coverage.¹⁸⁶ Thus, effective impact on the rate of increase and the price of premiums could be achieved, if at all, only by the second strategy; it is significant to note in this context that both Blue Cross and commercial insurance carriers in Massachusetts have been supportive of state cost containment efforts.¹⁸⁷

The price of insurance, then, creates incentives for affected constituencies to support hospital cost containment. Yet there are countervailing factors that reduce the consistency and fervor of such support. Three factors particularly affect the capacity of the business community to provide active leadership for cost containment. First, business' traditional distrust of government regulation produces the attitude that "if we support regulation of them, might it not increase regulation of us?" While it is possible to differentiate the need for regulation in the health

184. Mueller & Gibson, *Age Differences in Health Care Spending, Fiscal Year 1975, 1976 Soc. SEC. BULL.* 18, 19.

185. Section 1813 of the Social Security Act imposes a requirement on Medicare program beneficiaries for payment of certain deductibles and co-insurance portions. 42 U.S.C. § 1395e (1976).

186. See, e.g., MASS. STAT. ANN. ch. 175, § 47B (Law. Co-op 1977) (mandating coverage for certain mental health services).

187. Personal communications to the author by representatives of these groups.

field from the need for regulation in other areas of the economy,¹⁸⁸ the distinction may be irrelevant in the context of general interest in deregulation and widespread distrust of government. Thus, business is very likely to support nongovernmental efforts to contain costs, but tends to be at best ambivalent about the role government should play in regulating hospitals.¹⁸⁹

Second, executives of business organizations often serve on the boards of local hospitals.¹⁹⁰ Consequently, there may be a perceived conflict between corporate support of cost containment strategies aimed at hospitals and the fiduciary responsibilities of corporate executives as hospital trustees. Even if no legal conflict may exist, a corporate spokesperson's service on a hospital board may inhibit him or her from giving strong public endorsement of regulatory initiatives intended to restrict the cost behavior of hospitals generally.

Finally, it is not clear that the success of cost containment strategies will be of a direct benefit to employers. Premium payments are, after all, tax deductible. Further, to the extent some savings are achieved in premium expense, it is likely that employee benefit policies or collective bargaining will produce a reallocation of such "savings" into other areas of employee benefit expense. So, unless the employer has a strong preference concerning the type of fringe benefits it wishes to provide, savings from premiums may be a matter of indifference.

Similarly, organized labor has reason to be ambivalent about the potential success of cost containment programs. Major unions are likely to suffer direct adverse effects. Construction workers stand to lose job opportunities because of construction deferred or abandoned as a result of certificate of need decisions. And nonsupervisory workers fear that they will be the first affected by application of external budgetary constraints on hospitals. Consequently, general union support for cost containment efforts may be conditioned on exceptions for costs as-

188. See Havighurst, *Health Care Cost Containment Regulation: Prospects and an Alternative*, 3 AM. J. L. & MED. 310, 311-312 (1977).

189. See, e.g., NATIONAL CHAMBER FOUNDATION, A NATIONAL HEALTH CARE STRATEGY: HOW BUSINESS CAN IMPROVE HEALTH PLANNING AND REGULATION (1978). The Executive Summary of this report stresses the importance of businesses participating in public health planning agencies and private health planning activities to further cost containment objectives, but, as far as governmental regulation is concerned, only encourages participation in legislative debates over future health care system regulation without suggesting what positions should be taken. *Id.* at x.

190. See Berger & Earsy, *Occupations of Boston Hospital Board Members*, 10 INQUIRY 42 (1973).

sociated with wages paid to labor.¹⁹¹

The elderly, who are increasingly better organized for advocacy purposes, may have the least ambivalence about supporting hospital cost containment activities. Yet, the needs of the elderly relate to so many areas of society and the economy that organized groups representing their interests must continuously establish their priorities, with many other matters competing with hospital issues for attention. Indeed, in the health field alone, organizations of the elderly are also concerned with such issues as enhancing the quality of care in long-term care facilities and expanding community-based health services. To the extent hospitals represent a major source for expanding community-based services, such groups may be reluctant to take strong antihospital positions.¹⁹²

The pressure on Blue Cross to control premium increases has clearly had the effect, at least in Massachusetts, of moving it away from the very close relationship with hospitals that has been a source of past criticism.¹⁹³ Nevertheless, to the extent that Blue Cross' interest in cost containment is a function of marketing concerns, it may be expected to be as ambivalent toward governmental cost containment regulation as the large employers or employee groups that represent its principal purchasers.

In addition, Blue Cross has other constraints on its capacity to take an active role in this area. For example, Blue Cross in Massachusetts relies on voluntary contractual arrangements with hospitals for determining the terms and conditions of its payment on behalf of subscribers and for allowing it to pay hospitals on the basis of costs when costs are

191. The 1977 Cost Containment Act proposed by the Carter Administration contained an exemption from controls for wages and salaries of non-supervisory employees. H.R. 6575, 95th Cong., 1st Sess. § 124 (1977); S. 1391, 95th Cong., 1st Sess. § 124 (1977). The 1979 version of the proposed Cost Containment Act carries forward the proposal for such an exemption. See S. 570, 96th Cong., 1st Sess. §§ 2(b)(2), 2(c)(1)(A)(ii), 7(a)(1)(A). See also Mass. Hospital Workers Local 880, Elements Necessary for Local 880 to Support Hospital Controls (Unpublished position paper Feb. 15, 1976).

192. Expansion of community-based services by hospitals may be expected to occur in outpatient areas. It is significant in this context to note that the proposed Hospital Cost Containment Acts introduced by the Carter Administration into the 95th and 96th Congresses have consistently exempted hospital outpatient revenues from control. See H.R. 6575, 95th Cong., 1st Sess. (1977); S. 1391, 95th Cong., 1st Sess. (1977).

193. See, e.g., S. LAW, BLUE CROSS: WHAT WENT WRONG? 25-30 (1974). The corporate by-laws of Blue Cross of Massachusetts, Inc., provide that no more than five of the one hundred corporate members be "providers of health care or organizations representing such providers." By-Laws, Massachusetts Blue Cross, Inc. (November 1, 1972). The contract negotiated between Blue Cross and the Massachusetts Hospital Association in 1972-1973, HA-25-TH, represents one of the most progressive and cost containment-oriented Blue Cross agreements in the country. Five hospitals in the state initially refused to sign the agreement because of its provisions.

lower than charges.¹⁹⁴ Despite possible economic hardship, it is possible for hospitals to survive financially without a Blue Cross contract.¹⁹⁵ Thus, the harder Blue Cross tries to use the contract for cost containment purposes, or the more aggressively Blue Cross supports governmental cost containment programs, the more likely it is that hospitals may refuse to enter into contracts with Blue Cross.¹⁹⁶ In that situation, Blue Cross in Massachusetts is for all practical purposes bound to pay full charges.¹⁹⁷ It thereby loses some of its competitive advantage over commercial insurers, who would ordinarily make payments at charges, not the lower of costs or charges.

Unlike Blue Cross, commercial insurers do not rely on a contractual relationship with hospitals to determine the terms and conditions of payment. These insurers generally make payment based on hospital charges, which may or may not be related to the cost of providing services. When charges are higher than costs,¹⁹⁸ commercial insurers may be at a competitive disadvantage compared with Blue Cross, which under such circumstances will make payment based on cost. As a result, these insurers have a strong incentive to support those cost containment programs that call for regulating charges by relating them to definitions of allowable cost. Indeed, in order to eliminate the automatic differential that operates in favor of Blue Cross in most states, commercial insurers have made strenuous efforts to encourage the development of charge control programs that also provide for uniform rates for all purchasers.¹⁹⁹

194. See MASS. STAT. ANN. ch. 176A, § 5 (Law. Co-op 1977).

195. See letter to Stephen M. Weiner, Special Assistant to the Governor, from Henry D. Jones, President, Blue Cross of Massachusetts, Inc. (Aug. 9, 1973); RSC HA-27 Statement (1977), *supra* note 24, at 3.

196. See RSC HA-27 Statement (1977), *supra* note 24, at 2-3.

197. See *Massachusetts ex rel. Massachusetts Blue Cross, Inc. v. Mercy Hosp.*, No. 72-150 (Mass. Sup. Ct., November 13, 1972).

198. Charges may be higher than "cost" where a particular purchaser employs a restrictive definition of cost, such as excluding an allowance for bad debt and free care; or when the hospital wishes to build in a financial cushion or surplus. For examples of differences in cost definitions, see note 170 *supra*.

199. The Health Insurance Association of America (HIAA) sought hospital charge control legislation in Massachusetts as early as 1972. See S. No. 875 (1972); letter from Harold Hesnes to Hon. Robert L. Yasi, Secretary of Administration and Finance, Commonwealth of Massachusetts (Feb. 25, 1972). In 1977, funded primarily by the private insurance carriers, Government Research Corporation of Washington, D.C., developed through a task force a model bill for state-level ratesetting programs. See Statement of Robert D. Kilpatrick, President and Chief Executive Officer, Connecticut General Insurance Corporation, on the Hospital Cost Containment Act of 1977, delivered to Subcommittee on Health of the Senate Human Resources Committee, June 21, 1977. The model bill provided the basis for a legislative proposal announced by Senator Schweiker as an alternative to the Administration's Hospital Cost Containment Act. See 123 CONG. REC. E4220-21 (daily ed. July 1, 1977).

On the other hand, because of the absence of traditional relations with hospitals, the commercial insurers have had less involvement historically than Blue Cross in health policy development. Further, because most of them market other lines of insurance, their political attention must be directed to a number of issues simultaneously, which dilutes their capacity to provide effective political support to hospital cost containment efforts specifically.

This survey of the major potential cost control constituencies suggests that the state, in seeking to develop allies in its policy objectives, may find relatively little strong and consistent support for government cost containment initiatives. The state's position of relative isolation is further complicated when one considers an additional political characteristic of the hospital system—the status of hospitals themselves.

3. The Status of Hospitals

Virtually all of the acute care general hospitals in Massachusetts are nonprofit institutions.²⁰⁰ They enjoy the respect normally accorded charitable organizations. Further, most of the state's acute care general hospitals, with the possible exception of some of the major teaching institutions, are strongly identified with the communities in which they are located or to which they provide services.²⁰¹ This community identification is even stronger in nonprofit hospitals located away from large urban areas.²⁰² The local citizens view the hospital as "theirs"; there is a strong pattern of relationships with the facility, generally dating back for some period of time, and there is a sense of "pride" associated with having ready access to hospital services.

Most importantly, perhaps, the trustees of such hospitals are generally drawn from the dominant social and economic strata of the community.²⁰³ This has two beneficial effects for the hospital. First, the hospital may, as a result and with some reason, argue that its board understands the community needs, and those needs will therefore be adequately represented in internal hospital decisions with respect to prices and services. This argument easily becomes intertwined with the view, produced by the usual tension between small local communities

200. Of the 122 acute hospitals listed in the MASSACHUSETTS DEPARTMENT OF PUBLIC HEALTH, HEALTH DATA ANNUAL (1976), it is estimated that only ten were proprietary. Of that group, three ceased to function as acute hospitals after 1976.

201. BOSTON GLOBE, Jan. 31, 1979, at 1, col. 1 (discussing responses of citizens of small towns to perceived threat to local hospitals contained in draft state health plan).

202. *Id.*

203. See Berger & Earsy, *supra* note 190.

and state government, that the large "insensitive" state bureaucracy does not adequately understand the local scene and should not try to impose its view on the community.²⁰⁴ Second, the board provides a strong base from which hospitals may, individually or collectively, develop and exert political influence, especially on local state legislators.

The favored status of the individual community-based hospital is not necessarily diminished by generalized political and social concerns about cost containment. As discussed earlier, the direct impact of the cost increases incurred by a particular hospital is usually diffused through tax and insurance mechanisms,²⁰⁵ so that the community using the services of the hospital does not ordinarily feel directly the added financial burden placed on the health system by the institution's specific cost increasing decisions. Thus, while cost containment as an abstract concept may be supported by members of the community, it is a very different matter when an individual state cost containment decision has an adverse impact on the community's hospital, as opposed to hospitals generally.

V. STRATEGIES TO SUPPORT HOSPITAL COST CONTAINMENT REGULATORY AGENCIES

The preceding sections indicate some of the difficulties that confront "reformist" hospital cost regulatory agencies. Structural characteristics of the hospital service industry deprive the agencies of readily available "natural" constituencies to provide political support for their objectives. Further, the availability of procedural mechanisms by which segments of the public may participate in the agencies' decisional processes has not provided a vehicle for the agencies to develop political understanding of and support for their policies.

These difficulties that attend the functioning of "reformist" agencies raise the likelihood that they will evolve into "reluctant" ones as lack of a strong, supportive political constituency undercuts the willingness of the agencies to attempt substantial reform of the hospital industry. Indeed, perhaps the only factor that may retard such an evolution is the continuing budgetary concern of the government,²⁰⁶ which may be expected to support strong containment efforts by the regulatory agencies.

204. See BOSTON GLOBE, Jan. 31, 1979, at 1, col. 1.

205. See text accompanying notes 178-199 *supra*.

206. See text accompanying notes 163-177 *supra*.

Is such an evolution inevitable, however? The question is obviously an important one, both to the agencies currently engaged in hospital cost regulatory activities and to policy analysts who support increased governmental action to shrink the size of the existing hospital system. Asked another way, are strategies available that the agencies may pursue to build political support for their reformist objectives?²⁰⁷

Two approaches, at least, represent possibilities for building such support. Neither, however, provides any high degree of certainty of success. The first encompasses an intensive educational outreach effort by the agencies, the purpose of which is (a) to develop an understanding among different constituency groups of the relationship between the agencies' objectives and the group's particular concerns, (b) to seek a set of common understandings and objectives that may be reflected in the agencies' operations, and (c) to convert the educational activities into ongoing relationships that can be translated into political support for the common objectives. The second strategy involves developing a formal linkage between the agencies' regulatory activities on the one hand, and on the other, processes that may be viewed as having similar objectives but that necessarily involve a broader diversity of views than those represented in the agencies' activities. Of particular interest for linkage with regulatory activities are the planning and review responsibilities imposed on health systems agencies and state health planning and development agencies under the National Health Planning and Resources Development Act of 1974.²⁰⁸

A. *Educational Outreach Efforts*

This strategy proceeds from the view that if interest groups do not come to the agency, that is, are not generally willing to participate in the formal²⁰⁹ agency proceedings intended to invite broad public participation, then the agency must go to the interest groups. Ordinarily, such a strategy is more characteristic of legislative lobbying efforts on

207. The types of strategies considered here are not the more traditional ones involving efforts by the agency to increase the amount of personnel and budgetary resources made available to it. See, e.g., B. SMITH, *LIVING WITH CIVIL SERVICE: THE MASSACHUSETTS EXPERIENCE* (1976). Nor do they encompass efforts to restructure agency process to permit more effective interest group participation, an issue discussed in the text accompanying notes 1-11 *supra*.

208. National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (1975) (codified at 42 U.S.C. §§ 300k, 300t (1976)).

209. For purposes of this discussion the term "formal" is not used in the sense of the federal Administrative Procedures Act concept of formal rulemaking or adjudication as distinct from informal rulemaking. Instead, it is intended to distinguish agency action as required by statute, such as public notice and comment, from other kinds of agency actions.

behalf of an agency. For example, the Dukakis Administration in Massachusetts undertook extensive educational efforts in 1975 and 1976, particularly with business, labor and elderly groups, to explain the importance of the proposed Hospital Cost Containment Bill that culminated in Chapter 409.²¹⁰ Similar efforts have been undertaken by the Carter Administration nationally in 1979 in support of its proposed Hospital Cost Containment Act.²¹¹

Such outreach efforts, consciously aimed at developing public/political support for an agency's position, are relatively rare at the level of administrative, as opposed to legislative, activities. One example, however, is the so-called generic process used in developing standards and criteria for the Massachusetts DON program.²¹² The process involves extensive consultation among interested and knowledgeable parties aimed at developing standards and criteria to be embodied in regulations governing treatment of projects proposed under the DON program. The DPH does not undertake the consultative process with a detailed product already developed, but instead makes use of the common objective of the parties and the value placed on developing acceptable cost containment-oriented rules as the parameters of the process. The consultative process itself shapes the final product, which takes the form of recommendations for proposed DPH regulations.

At least theoretically, the DPH's use of the generic process enables it to make participating groups aware of its values and objectives. At the same time, participation by the various groups themselves may commit them politically to the end result, even if any one of them alone, including the DPH, would not have been independently willing to accept the product. By entering into the process, the DPH or another regulatory agency has the opportunity to shape the results of its policy goals, but at the same time, and in exchange for that, it must recognize that, to a large extent, it gives up its ability to determine the precise details of the resulting recommendations. Just as the participant groups are psychologically committed to the result, if the process is sensitively handled, so is the agency committed to it as well.

The generic process is organized around specific products. One can envision a variant of this educational strategy that does not necessarily produce a set of recommendations for proposed regulations, but

210. See background documents and strategy papers concerning efforts to enact H. 3160, in the personal files of the author.

211. See, e.g., HEALTH REGULATION LETTER, March 10, 1979, at 1-2.

212. See Massachusetts Dep't of Public Health, Draft State Health Plan §§ 1.15-1.16 (1978).

instead allows for an informal and ongoing sharing of views and objectives by diverse sets of groups, all of which are affected by the agency's responsibilities. Three characteristics mark this kind of process: informality, continuity and focus on the agency's general programmatic activities, not on a specific product.²¹³ Such a process permits the agency to explicate its policies and objectives in a more discursive fashion than generally attends agency statements in formal administrative procedures. It thereby provides a forum in which the agency can develop understanding for its positions among the participating groups. At the same time, such a continuing interchange would permit the other participants to educate the agency about their attitudes and positions in a more detailed fashion than might ordinarily be available in formal procedures. The agency might thereby better understand the impact of its activities on various affected groups, an impact that might not be readily discernable in formal statements prepared by representatives of the various groups for presentation at public hearings.²¹⁴ With such an understanding, the agency would be more likely to consider alternative methods of achieving its objectives.

While the educational approach represents one strategy available to a reformist agency, use of it raises a number of problems. Three are particularly important. First, none of the possible variants of this model precludes co-option of the agency by dominant industry interests, which are presumably entitled to participation. Certain factors, however, may impede such a result. First, participation would be open to more than just the agency and the regulated industry. Other groups, the interests of which are not necessarily consistent with the industry's, would be included. In either a task-specific or an ongoing relationship, this diversity of participation should serve as a countervailing force to the industry's position. Second, it may be expected that co-option occurs when the agency either willingly or passively accepts such a result. The agency's participation in the educational outreach strategy, however, is intended specifically to avoid such a result and to develop sup-

213. An example of one type within this model is the Maryland Health Care Coalition, largely inspired by the Health Insurance Association of America (HIAA), in which the Maryland Health Services Costs Review Commission participates. *See* Health Insurance Association of America, *Goals and Objectives of the Maryland Health Care Consortium* (1978).

214. The model envisioned is different from an advisory council structure in that (a) it is not officially established by a statute or formal agency action and (b) participation by various interest groups is more active, with more individuals from each group involved than is typically the case with advisory groups. Further, advisory boards typically function to provide advice to the agency but not necessarily to communicate agency positions to the constituent parties. The model described in effect functions in the first place to communicate information from the agency to private groups.

port for the agency in its regulatory relations with the industry. In a sense, then, an agency willing to enter into such a strategy will already be conscious of efforts to co-opt it and can develop countervailing tactics to prevent co-option from occurring.

Second, the educational outreach strategy may render formal public notice and comment processes irrelevant or meaningless. Major policies may be agreed upon and, in the case of the DON generic process, specific regulatory provisions may be worked out in some detail prior to promulgation of proposed regulations. The extent to which informal activities undercut the meaningfulness of formal agency actions is necessarily a matter of some concern. As a result of this concern, new types of public notice have been developed, such as the notice of intent to issue proposed regulations, evidencing an effort to move the possibility for public participation back into earlier stages of the agency's policy development process than may have ordinarily occurred under standard APA notice requirements. Further, the educational outreach strategy, which is initiated by the agency, does not necessarily involve all the parties that might respond to a public notice. Indeed, to the extent the agency attempts to target particular politically influential groups for inclusion in the educational process, the strategy is likely to encompass participation by a relatively small segment of the available spectrum of interests. Yet if common agreement on policy and objectives emerges from processes like the DON generic process described earlier, then the decision concerning inclusion or exclusion of certain interests could effectively foreclose the excluded parties from any meaningful participation at any stage of the policy development process, up through the stage of formal adoption. The agency may thereby gain political support at the expense of traditional notions of public accountability and participation. Even though there may be no extensive public participation in the agency's formal procedures,²¹⁵ the possibility that such participation can occur and have an impact is an important principle to retain.

Third, the idea of an agency initiating efforts to gain public and political support for its policies is not one envisioned by traditional legal models of the administrative agency. These models tend generally to derive from considerations of the legitimacy of administrative actions.²¹⁶ Legitimacy may attach to agency action to the extent the ac-

215. See text accompanying notes 86 & 87 *supra*.

216. For a discussion of the legitimacy of actions by administrative agencies, see J. FREEDMAN, *CRISIS AND LEGITIMACY* 259-266 (1978).

tion can be seen as clearly following from a legislative policy,²¹⁷ or as involving application of objective expertise to a particular set of factual circumstances,²¹⁸ or as representing a conception of a public interest developed from a balancing by the agency of conflicting and competing interests. The models, based on these sources of legitimacy, have a common characteristic in that they appear to assume a passive agency having as its only interest the performance of its delegated responsibilities. A reformist agency undertaking an educational outreach strategy, however, is assumed to be an activist agency attempting to build support for its position. The position taken presumably derives from an interpretation of the agency's legislative authority, and therefore is one the agency can legally—even if not necessarily politically—sustain. Thus, the DPH or the RSC, in administering DON or Chapter 409, could undertake an outreach strategy without having questions raised about the policies it is pursuing. But an agency seeking cost containment objectives in the absence of a defined legislative mandate—such as if one of the Massachusetts agencies were to undertake a shrinkage strategy under current statutory provisions²¹⁹—might face not only strictly legal questions concerning the scope of its authority, but questions concerning the very legitimacy of the agency's conduct. In pursuing an educational outreach strategy in the absence of relatively clear statutory policy, the agency is in effect going beyond the conception of agency action embodied in traditional doctrines. A significant issue requiring further exploration is what theory of legitimacy would support the agency under such circumstances.²²⁰

B. The Planning Strategy

An alternative strategy that allows the agency to retain a passive role while developing support for its positions is to build upon the planning and review activities undertaken under the National Health Planning and Resources Development Act of 1974. This federal legislation establishes two planning bodies within a state that, in their composition, reflect the varied interest groups within the health system: the health systems agency (HSA) and the statewide health coordinating

217. For an analysis of this concept, see Stewart, *supra* note 2, at 1672-76.

218. *Id.* at 1677-78.

219. See note 29 and accompanying text *supra*.

220. Relatively little rigorous analysis has been undertaken of the concept of agency legitimacy. An excellent example of this limited literature is J. FREEDMAN, *supra* note 216.

council (SHCC).²²¹ The HSA is responsible for developing the health systems plan (HSP) for its area, and the annual implementation plan (AIP) aimed at achieving the goals of the HSP.²²² It also reviews and provides recommendations on such matters as applications from the area for various federal funds,²²³ the appropriateness of institutional services provided within the area²²⁴ and applications for certificates of need emanating from institutional providers within the area.²²⁵ While not specifically required as yet, it may be expected that review activities undertaken by an HSA will eventually be based on standards derived from the area HSP and AIP.

The SHCC is responsible for adopting a state health plan (SHP), which is made up from the area HSPs with adjustments for differences arising from a statewide perspective.²²⁶ Again, while not yet specifically required by federal statute, the SHP may eventually provide the basis for standards applicable in the administration of statewide appropriateness review or certificate of need processes by the state health planning and development agency.²²⁷

Two characteristics of the National Health Planning and Resources Development Act of 1974 suggest that the process of developing the HSP and SHP is intended to be a consensual one. First are the requirements concerning composition of the boards of the HSAs and of the SHCC.²²⁸ Membership is prescribed to reflect and balance the di-

221. National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, §§ 1512, 1513, 1524, 88 Stat. 2234 (codified at 42 U.S.C. §§ 300/-1, -2, 300m-3 (1976)).

222. *Id.* § 1513(b)(2), (3) (codified at 42 U.S.C. § 300/-2(b)(2), (3) (1976)).

223. *Id.* § 1513(e) (codified at 42 U.S.C. § 300/-2(e) (1976)).

224. *Id.* § 1513(g) (codified at 42 U.S.C. § 300/-2(g) (1976)).

225. *Id.* § 1513(f) (codified at 42 U.S.C. § 300/-2(f) (1976)).

226. *Id.* § 1524(c)(2) (codified at 42 U.S.C. § 300m-3(c) (1976)).

227. One version of the proposed amendments to the National Health Planning and Resources Development Act of 1974 introduced into the first session of the 96th Congress, calls for requiring that certificate of need decisions "shall not be inconsistent with the State health plan." See proposed section 1527(a)(6) of Title XV of the Public Health Service Act, H.R. 3041, 96th Cong., 1st Sess. (1979).

228. The Act provides for the following membership on the governing board and executive committee, if any, of an HSA:

(i) A majority (but not more than 60 per centum of the members) shall be residents of the health service area served by the entity who are consumers of health care and who are not (nor within the twelve months preceding appointment have been) providers of health care and who are broadly representative of the social, economic, linguistic and racial populations, geographic areas of the health service area, and major purchasers of health care.

(ii) The remainder of the members shall be residents of the health service area served by the agency who are providers of health care and who represent (I) physicians (particularly practicing physicians), dentists, nurses, and other health professionals, (II) health care institutions (particularly hospitals, long-term care facilities, and health main-

versity of interests in the health system. Almost as a matter of necessity, agreement upon an HSP or SHP from such an organizational structure must come from a process of negotiation and accommodation. A final product depends on development of a block representing a majority of the members, not a single decisionmaker. But the credibility of the process—that is, the willingness of all the requisite parties to participate in it—turns on each party being satisfied to some extent with the accommodation.

The second characteristic is that there is no direct authority for the

tenance organizations), (III) health care insurers, (IV) health professional schools, and (V) the allied health professions. Not less than one-third of the providers of health care who are members of the governing body or executive committee of a health systems agency shall be direct providers of health care (as described in section 1531(3)).

(iii) The membership shall—

(I) include (either through consumer or provider members) public elected officials and other representatives of governmental authorities in the agency's health service area and representatives of public and private agencies in the area concerned with health,

(II) include a percentage of individuals who reside in nonmetropolitan areas within the health service area which percentage is equal to the percentage of residents of the area who reside in nonmetropolitan areas, and

(III) if the health systems agency serves an area in which there is located one or more hospitals or other health care facilities of the Veterans' Administration, include, as an ex officio member, an individual whom the Chief Medical Director of the Veterans' Administration shall have designated for such purpose, and if the agency serves an area in which there is located one or more qualified health maintenance organizations (within the meaning of section 1310), include at least one member who is representative of such organizations.

42 U.S.C. § 3001-1(b)(3)(C) (1976). The Act provides for the following membership on the SHCC:

(A) (i) A SHCC shall have no fewer than sixteen representatives appointed by the Governor of the State from lists of at least five nominees submitted to the Governor by each of the health systems agencies designated for health service areas which fall, in whole or in part, within the State.

"(ii) Each such health systems agency shall be entitled to the same number of representatives on the SHCC.

"(iii) Each such health systems agency shall be entitled to at least two representatives on the SHCC. Of the representatives of a health systems agency, not less than one-half shall be individuals who are consumers of health care and who are not providers of health care.

"(B) In addition to the appointments made under subparagraph (A) the Governor of the State may appoint such persons (including State officials, public elected officials, and other representatives of governmental authorities within the State) to serve on the SHCC as he deems appropriate; except that (i) the number of persons appointed to the SHCC under this subparagraph may not exceed 40 per centum of the total membership of the SHCC, and (ii) a majority of the persons appointed by the Governor shall be consumers of health care who are not also providers of health care.

"(C) Not less than one-third of the providers of health care who are members of a SHCC shall be direct providers of health care (as described in section 1531(3)).

"(D) Where two or more hospitals or other health care facilities of the Veterans' Administration are located in a State, the SHCC shall, in addition to the appointed members, include, as an ex officio member, an individual whom the Chief Medical Director of the Veterans' Administration shall have designated as a representative of such facilities."

Id. § 3001-2(c) (1976).

HSAs or the SHCC to implement the plans. The only specific reference in the Act to a plan implementation strategy involves recourse to persuasion and the use of technical assistance and developmental funding.²²⁹ As was noted earlier, there is no requirement that the plans provide the basis for recommendations or findings on the appropriateness of existing institutional services or the need for new institutional services.²³⁰

These two characteristics, taken together, suggest the logic of combining the planning and regulatory processes, so that the plans provide the policy basis for regulatory decisions.²³¹ While there are clearly logistical and philosophical difficulties associated with such a linkage,²³² there would be significant advantages to the regulatory agencies from such an arrangement. First, the goals and objectives of the planning process, as established in the Act and such documents as the National

229. The Act provides the following with respect to implementing HSPs and AIPs:

(1) The agency shall seek, to the extent practicable, to implement its HSP and AIP with the assistance of individuals and public and private entities in its health service area.

(2) The agency may provide, in accordance with the priorities established in the AIP, technical assistance to individuals and public and private entities for the development of projects and programs which the agency determines are necessary to achieve the health systems described in the HSP . . .

(3) The agency shall, in accordance with the priorities established in the AIP, make grants to public and nonprofit private entities and enter into contracts with individuals and public and nonprofit private entities to assist them in planning and developing projects and programs which the agency determines are necessary for the achievement of the health systems described in the HSP. Such grants and contracts shall be made from the Area Health Services Development Fund of the agency established with funds provided under grants made under section 1640. . . .

42 U.S.C. § 3001-2(c) (1976).

230. This distinction between the project review responsibilities of HSAs, either through appropriateness review or review of new institutional services, and the goals and objectives of the HSPs and AIPs is implicitly recognized in DHEW regulations governing reviews by state health planning agencies with respect to certificates of need for new institutional services. 42 C.F.R. § 123.407(a) (9) (1978) requires the state agency to provide to the HSA "a written detailed statement" of the reasons why its decision regarding a proposed new institutional health services is inconsistent "with a *recommendation made with respect thereto* by the health systems agency making such recommendation." (Emphasis added.) The regulation further provides that if the state agency "makes a decision regarding a proposed new institutional health service which the State Agency determines *is not consistent with the goals of the applicable health systems plan . . . or the priorities of the applicable annual implementation plan*," the agency is again required to submit a "written, detailed statement of the reasons for the inconsistency." *Id.* § 123.407(a) (11) (emphasis added).

The separation of these two provisions implies that the recommendation of the HSA with respect to a certificate of need application itself need not be consistent with the HSA's own HSP or AIP.

231. See generally K. BAUER, *THE ARRANGED MARRIAGE OF HEALTH PLANNING AND REGULATION FOR COST CONTAINMENT UNDER P. L. 93-641 — SOME ISSUES TO BE FACED* (1977); Weiner, *supra* note 29.

232. See Weiner, *supra* note 29, at 57-63.

Guidelines for Health Planning,²³³ are compatible with the objectives of the cost containment regulatory agencies. The overview contained in the Supplemental Information accompanying the National Guidelines, for example, stresses the importance of cost containment as a prerequisite for achieving other goals in the health delivery system.²³⁴ Second, the development of the plans occurs through a structured, community-based, and broadly participatory process, at both the area and state levels, involving public hearings and decisions by representative groups. The types of interest that ought to participate in the formal regulatory proceedings participate in the plan development process. Because of the consensual nature of the process, it may be expected, as suggested earlier, that the participants will be more committed to the end-product than they would be if the same product emerged from a formal regulatory proceeding.

Consequently, were the regulatory agencies to adopt the goals and policies of the planning documents as the basis for their decisions, there would be a high likelihood that the same groups who participate in the development process would support the agency's decisions. To the extent that the plans were themselves converted into institution-specific recommendations and findings through the AIP, certificate of need or appropriateness reviews, adoption of these recommendations and findings as regulatory decisions would also presumably enhance the acceptability of those decisions.

Despite the political advantages to the regulatory agencies of linking planning with regulation, there are some pitfalls. First, there are logistical problems of administrative law associated with translating the plans and institution-specific recommendations into regulatory decisions, although most of the problems appear capable of resolution.²³⁵ Second, there is no assurance that the plan development process will actually be free of dominant industry influence, despite the minority status of providers on the HSA board and on the SHCC. While at least one recent study has suggested that the anticipated co-option of HSAs may not be occurring, it ascribes the result at least in part to HEW's insistence on evaluating HSAs from the perspective of cost containment concerns.²³⁶ There may, however, be no structural characteristics

233. 42 C.F.R. pt. 121 (1978).

234. 43 Fed. Reg. 13,040 (1978).

235. See text accompanying notes 231-34 *supra*.

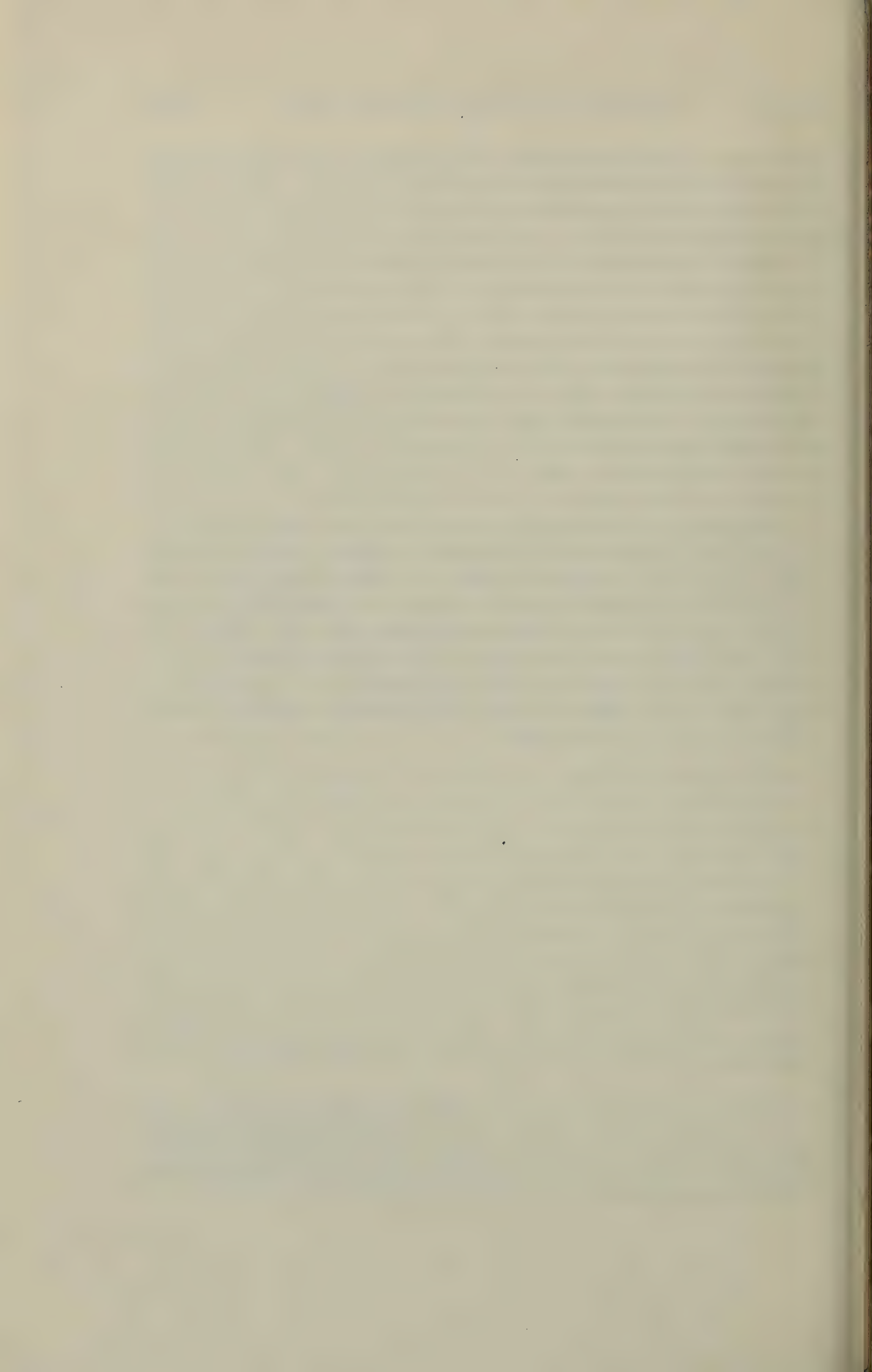
236. See Sapolsky, Altman & Greene, Assessing the Health Planning Experiences Under P. L. 93-641 9-10, 20 (1978) (unpublished paper on file in the office of the *North Carolina Law Review*).

preventing provider dominance. At the least, regulatory agencies adopting the planning strategy must carefully assess the extent to which HSAs and the SHCC are pursuing objectives compatible with the interests of the agencies.²³⁷

Third, incorporation of planning outcomes into regulatory decisions may affect the consensual nature of the planning process. The capacity of the HSAs and the SHCC to develop consensus on plans may in large part be due to the very absence of direct means of implementing the policies of the planning documents. Linking planning and regulation may increase the stakes associated with participation, particularly for providers, and may make providers far less willing to cooperate in plan development. Such an occurrence would undermine the consensual nature of the process—the major value of planning as a means of providing support to regulatory decisions.

The strategy of linking planning and regulation may be of significant advantage to the cost containment regulatory agencies seeking public and political support for their decisions. Nevertheless, there may be difficulties, practical and theoretical, associated with the strategy that require extensive analysis before embarking on it. Since questions and difficulties are associated with both of the two major support-building strategies, however, it may be necessary for the agencies to undertake a certain amount of risk if they intend to continue acting as reformers of the regulated system.

237. The potential co-option of HSAs raises a difficult question of legitimacy. If a governmentally sanctioned and apparently democratic process is not capable of preventing one group or a relatively small number of groups from dominating the results of that process, what arguments support the greater legitimacy of a bureaucratic agency refusing to accept the values associated with the result and superimposing its own views on the process?



MAKING CERTIFICATE OF NEED WORK

MICHAEL K. SCHONBRUN†

Inflation in the last third of this century has become an obsession of the American polity.¹ Several factors, now widely accepted as causes of the country's inflation, have been cited repeatedly by economists, planners, industrial leaders and politicians in both major parties. Excessive government spending and over-regulation of business have been attacked, specifically the alleged high cost of complying with government regulations and the reported stifling of competition and innovation through the bureaucratization of key social and economic decisions.² The decline in productivity among American workers has also been cited,³ while American consumers have been blamed for displaying little self-restraint in their purchasing and credit practices, for neglecting to take such preventive actions as installing proper home insulation, and for refusing to utilize efficient but inconvenient measures such as mass transit.⁴ Inflation has also been attributed to the

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1. See, e.g., Silk, *Inflation: A Showdown Is At Hand*, N.Y. Times, Jan. 7, 1979, § 12, at 1. Silk, writing the lead story for the newspaper's year-end *National Economic Survey*, quoted President Carter's description of inflation as "the most complicated and intractable and corrosive problem of them all." *Id.* at 62.

2. See, e.g., Holsendolph, *Deregulation: Panacea or Pandora's Box?*, N.Y. Times, Jan. 7, 1979, § 12, at 28. Holsendolph cites a report by two economists at Washington University in St. Louis, Murray L. Weidenbaum and Robert DeFina, which found that in 1976 the total annual cost of federal regulation, including administrative costs and compliance costs, was \$66 billion and predicted that these costs would exceed \$103 billion by 1979. *Id.*

3. Worker productivity increased only 0.4% in 1978—consistent with the generally poor record of the last ten years when the productivity rate has risen only 1.6% a year—half the average annual growth rate in productivity experienced by American workers from 1947 to 1967. Workers' hourly compensation increased by 9.3% during the same period—the largest increase in 27 years. "Because that sharp rise was not offset by a large productivity gain, labor costs for producing goods and services rose 8.9 percent, the second largest increase ever." *Rocky Mountain News*, Jan. 27, 1979, at 76, col. 2.

4. See, e.g., Ettore, *Consumers Pile Up Debt to Buy Homes, Furs, Autos*, N.Y. Times, Jan. 7, 1979, § 12, at 10. See also President Carter's speech, *The Energy Problem*, 15 WEEKLY COMP. OF PRES. DOC. 560 (Apr. 25, 1977).

rapid introduction into our society of gadgetry and technology and the accompanying advertising campaigns that present new but soon to be obsolete products in alluring packaging.⁵ Finally, nonprofit institutions such as universities, community-based charitable collection services (United Way, Community Chest, etc.), and social welfare agencies have been hard hit by rising prices and have passed on these higher costs to their clients and benefactors.⁶

Many of these same forces operate in the health care sector of the economy. Indeed, with costs of health care rising 400 percent since 1965,⁷ inflation of health care costs has exceeded even that of other sectors of the economy, leading President Carter to identify the containment of hospital costs as the leading priority in his administration's fight against inflation.⁸ Since the advent of Medicare and Medicaid in 1965, government spending for personal health services has increased from 9.5 to 68.4 billion dollars in 1977—nearly seven fold.⁹ New government bureaucracies and regulatory programs have burgeoned during the past ten years. The lack of price competition among hospitals has been frequently cited as a chief cause of inflation, together with the hegemony of the fee-for-service physician who serves as both the gatekeeper to the entire health care system and as a major economic beneficiary of this highly utilized system.¹⁰ In addition, because of the now widely accepted principle that health care is a "right," immediate proximity to a full-service hospital has been widely, if inappropriately, regarded by the public as a necessity—thus providing a medical and quasi-legal rationale for the preexisting American penchant for convenience.¹¹

5. See generally J. GALBRAITH, *THE NEW INDUSTRIAL STATE* (2d ed. 1977).

6. See generally Vladeck, *Why Non-Profits Go Broke*, *THE PUBLIC INTEREST*, Winter 1976, at 86.

7. Gibson & Fisher, *National Health Expenditures, Fiscal Year 1977*, *SOC. SEC. BULL.*, July 1978, at 5.

8. See Remarks by President Carter on the Administration's Hospital Cost-Containment Bill of 1979, 15 *WEEKLY COMP. OF PRES. DOC.* 383 (Mar. 6, 1979); the 1978 year-end interview of Hamilton Jordan, President Carter's Assistant for Political Affairs, who asserted that the "administration's biggest disappointments [were] ending 1978 without a peace treaty between Israel and Egypt and starting 1979 without a law putting a lid on hospital costs." *Rocky Mountain News*, Dec. 29, 1978, at 1, col. 1.

9. Gibson & Fisher, *supra* note 7, at 5.

10. See Enthoven, *Consumer-Choice Health Plan*, 298 *NEW ENGLAND J. MED.* 650 (1978). See also Havighurst, *Regulation of Health Facilities and Services by "Certificate of Need,"* 59 *VA. L. REV.* 1143, 1155-69 (1973).

11. See, e.g., LOUIS HARRIS & ASSOCS., INC., *HOSPITAL CARE IN AMERICA* (1978) [hereinafter cited as LOUIS HARRIS POLL]. When queried whether they would be willing to pay a higher hospital bill out of their own pocket to keep a specific service in their *closest neighborhood* hospi-

Furthermore, for better or worse, the health care system is now highly dependent on technology.¹² It is a system whose primary institutions, hospitals, are nonprofit.¹³ It is labor intensive, employing over 4.6 million people,¹⁴ and it represents one of the few sectors in the American society in which recent labor organizing efforts have been successful and in which blue-collar workers have enjoyed real salary improvements in the past decade.¹⁵ Finally, the health care industry itself is not only politically well organized with such national lobbying and trade organizations as the American Medical Association, the American Hospital Association, and the Blue Cross Association, but its constituents—most notably doctors, hospital trustees, and insurance company executives—are often the civic cornerstones of the nation's communities. Individually as well as collectively, they exercise great power as local opinion leaders.

It is into this highly inflationary, complex and politically volatile industry that new regulatory programs such as certificate of need, prospective rate review, and medical peer review (PSROs) have been introduced. These programs are designed to inject considerations of efficiency, effectiveness and equity into the health care industry. It is no small order, especially at a time when public mistrust of governmental programs is high.¹⁶

The basic premise of the health reformers, champions of these programs, is that there is substantial waste and inefficiency in the health system and that, if left alone, the dysfunctions of the system will con-

tal, the respondents said yes to each of the following services: cardiac care unit (76% of respondents), emergency room (73%), kidney machines for renal dialysis (62%), open heart surgery (59%), cancer therapy (56%), and CAT scanner (53%). *Id.* at 85.

12. See generally Iglehart, *The Cost and Regulation of Medical Technology: Future Policy Directions*, 55 MILBANK MEM. FUND Q. 25 (1977).

13. In 1976, 89% of the beds and 87% of the country's nonfederal short-term general and other special hospitals were nonprofit. AMERICAN HOSPITAL ASSOCIATION GUIDE TO THE HEALTH CARE FIELD 7-9 (1977). Based on industry-supplied figures, nonprofit hospitals in some states are struggling financially. Four out of every five nonprofit hospitals in New York State sustained an operating loss in 1977. Newsletter of Colorado Chapter, Hospital Financial Management Association, February 12, 1979.

14. Television interview with Dr. James Sammon, Executive Vice President of the American Medical Association, broadcast on Channel 3, New York City (Jan. 20, 1978, 6:30 p.m.).

15. From 1966 to 1975, the average annual rate of increase in earnings for hourly workers in hospital settings was 8.7%, compared to 5.8% for comparable workers in other non-farm settings. M. FELDSTEIN & A. TAYLOR, *THE RAPID RISE IN HOSPITAL COSTS* (Council for Wage and Price Stability 1977).

16. LOUIS HARRIS POLL, *supra* note 11, at 56. The poll showed that 46% of respondents were opposed to additional government regulation, 38% were in favor, and 16% were not sure. Interestingly, of those who were patients within the year, 42% were in favor, 41% opposed, and 17% not sure.

tinue unabated.¹⁷ The reformers hold that the costs of providing good quality health services can and should be cut back or at least redirected and controlled. They cite the lack of correlation between per capita expenditures and health status, the regional differences in hospital length-of-stay and admission rate per capita, which show little relationship to mortality or morbidity figures, and the notable discrepancies in per capita expenditure levels and utilization rates between organized prepaid group practices and the still dominant fee-for-service delivery system.¹⁸

This article will indicate how one of these new regulatory programs—certificate of need—can be employed to help rationalize the American health care delivery system. The author recognizes the pervasiveness, longevity and multiple origins of the current American inflation, the established structural facts about the American health care system (for example, the continued predominance of the fee-for-service system), and the prevailing skepticism about governmental regulatory programs marked, in part, by the recent rebirth of “free market” strategists and “antitrusters.”¹⁹ Consequently, the policy initiatives proposed here will be compatible with both the realities of the American health care scene and the current predispositions of the American public and its political, economic and community leaders.²⁰

17. See, e.g., Remarks of Joseph A. Califano, Jr., before the National Academy of Sciences, Washington, D.C., October 26, 1978, at 11-15 (U.S. Government Printing Office 1978) [hereinafter cited as Remarks of Joseph A. Califano].

18. See, e.g., Bunker, *Surgical Manpower*, 282 NEW ENGLAND J. MED. 135 (1970). See also *Getting Ready for National Health Insurance: Unnecessary Surgery, Hearings Before the Subcomm. on Oversight and Investigations of the Comm. on Interstate and Foreign Commerce, House of Representatives*, 94th Cong., 1st Sess. 73-87 (1975) (testimony and statement of John Wennberg); Gaus, Cooper & Hirschman, *Contrasts in HMO and Fee-for-Service Performance*, SOC. SEC. BULL., May 1976, at 3; Lembcke, *Measuring the Quality of Medical Care Through Vital Statistics Based on Hospital Service Areas: I. Comparative Study of Appendectomy Rates*, 42 AM. J. PUB. HEALTH 276 (1952).

19. See Iglehart, *Adding a Dose of Competition to the Health Care Industry*, 10 NAT'L J. 1602 (1978). Iglehart provides a brief historical account of the new interest in the health care sector of the Federal Trade Commission and the Justice Department's Antitrust Division, and quotes FTC Chairman Michael Pertschuk's explanation for his agency's recent activity: "The commission—like most other agencies of government—was slow to admit that one possible way to control the seemingly uncontrollable health sector could be to treat it as a business and make it respond to the same marketplace influences as other American businesses and industries." *Id.* See generally Enthoven, *supra* note 10; Havighurst, *supra* note 10.

20. See generally Marmor, Wittman & Heagye, *Politics, Public Policy, and Medical Inflation*, in *HEALTH: A VICTIM OR CAUSE OF INFLATION* (M. Zubkoff ed. 1976); see also Demkovich, *Health Planning Agencies Face Threat From Deregulators*, 11 NAT'L J. 687 (1979); Iglehart, *Why Hospitals Are Waging War on Regulations*, 11 NAT'L J. 20 (1979).

I. THE CERTIFICATE OF NEED MECHANISM

Certificate of need (CON) was first introduced in this country in 1964 in New York, and similar programs are now operating in all states except Missouri.²¹ Most commentators assert that the primary motivation for CON enactment in New York and its subsequent passage in other states was cost containment. The salutary effect of the mechanism on health care inflation occurs, its advocates state, by limiting the effects of "Roemer's law."²² Roemer postulated that, because of the lack of price competition, the lack of discriminating consumer behavior, and the pervasiveness of third-party coverage in the health marketplace, a "bed built was a bed filled," regardless of community need, financial feasibility, or impact on quality of care.²³ While highly controversial at the time of its initial pronouncement, Roemer's law is now widely accepted. By preventing unnecessary capital expenditures, not only can the cost of the initial construction or acquisition be saved, but also the accompanying operating expenses. For example, it has been estimated that the operating cost for every new piece of equipment will equal the original cost in a period of two to two and one-half years, and for the CAT scanner, the first-year operating cost alone may equal or exceed the purchase cost.²⁴

The mechanisms of CON²⁵ vary from state to state. Its fundamen-

21. CHAYET & SONNENREICH, P.C., CERTIFICATE OF NEED: AN EXPANDING REGULATORY CONCEPT 5-6 (1978).

22. See generally W. McCLURE, REDUCING EXCESS HOSPITAL CAPACITY (1976); INSTITUTE OF MEDICINE OF THE NATIONAL ACADEMY OF SCIENCES, CONTROLLING THE SUPPLY OF HOSPITAL BEDS 7-16 (1976).

23. Roemer, *Bed Supply and Hospital Utilization*, HOSPITALS, November 1, 1961, at 36. See also Wennberg & Gittelsohn, *Small Area Variations in Health Care Delivery*, 182 SCIENCE 1102 (1973). But see M. FELDSTEIN, ECONOMIC ANALYSIS FOR HEALTH SERVICE EFFICIENCY 201-221 (1968); INSTITUTE OF MEDICINE OF THE NATIONAL ACADEMY OF SCIENCES, *supra* note 22, at 18.

24. Somers & Somers, *A Proposed Framework for Health and Health Care Policies*, 14 INQUIRY 115, 153 (1977).

25. Unless otherwise indicated, the term "certificate of need" (CON) will be used in its broadest sense, referring to the generic kind of regulatory control that is being exercised over capital expenditures; consequently, state CON statutes, the federal 1122 review program (Social Security Amendments of 1972, Pub. L. No. 92-603, 86 Stat. 1386 (codified at 42 U.S.C. § 1320a-1 (1976))), and even those reviews backed by sanctions in conformance clauses of privately sponsored reimbursement contracts (most notably those developed by miscellaneous Blue Cross plans) will all be included in the review. Because of requirements in the National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (codified at 42 U.S.C. §§ 300k-300t (1976)), with which states must comply by 1980, and the anticipated repeal of the 1122 program (promised by HEW to occur when states comply with the planning act's standards), the federal CON procedures and standards most frequently cited in this article will be based on the requirements of 42 U.S.C. §§ 300m-300t (1976). The analysis will not be limited, however, to the federal requirements, since only seven states had federally conforming programs as of October 1978 and most of the nation's experience with CON has been with a wide range of systems. Fur-

tal principles, however, are generally uniform and entail administrative procedures basically analogous to those involved in issuing permits or licenses. A CON is essentially a license required by the state before certain types of medical care projects may be initiated. The CON process is composed of several stages. A project is initiated by a health care provider, customarily an institutional provider, although physician offices have been included in several state laws. It is then submitted to the reviewing agency, either an agency of state government or the quasi-governmental health systems agency (HSA), for approval. In many states, such as Colorado, projects are submitted concurrently to both; the division of authority between the two, however, is not always clear.

After a determination that the project is subject to review (it exceeds a specific dollar threshold, it is not subject to a "grandfather" clause, etc.), the substantive review of the project's merit commences. Within a fixed time period (now ninety days under P.L. 93-641²⁶), the project is reviewed for conformity with existing standards, criteria and plans that under the tenets of health planning stand as the basic measuring instruments used to evaluate community need. Specifically, it is studied for financial feasibility and for its effect on prevailing community health costs and quality and availability of care. In some states, including Colorado, the burden of proof is clearly on the proponent of the project. In other states, the location of the burden of proof is not clear.²⁷ Under the provisions of P.L. 93-641, the burden will clearly be on the project's proponent, at least for inpatient hospital services.²⁸

Under CON statutes all licensed hospitals and, in most states, all licensed nursing homes are subject to review regardless of the source of financing for the project.²⁹ Failure to obtain a CON renders the provider subject to such sanctions as loss of license, injunctive proscription and ineligibility for payment from some or all third-party payors.

The CON process is generally classified as adjudicatory.³⁰

thermore, this article will focus on the hospital sector—the most inflationary part of the health care industry—where CON controls have been used longer and more extensively than elsewhere.

26. National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (1975) (codified at 42 U.S.C. §§ 300k-300t (1976)).

27. See generally Bovbjerg, *Problems and Prospects for Health Planning: The Importance of Incentives, Standards, and Procedures in Certificate of Need*, 1978 UTAH L. REV. 83, 118-120.

28. See 42 C.F.R. § 122.309 (1978).

29. North Carolina *ex rel.* Morrow v. Califano, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978); see CHAYET & SONNENREICH, P.C., *supra* note 21, at 9-11.

30. See, e.g., Minnesota State Bd. of Health v. Governor's Certificate of Need Appeal Bd., 304 Minn. 209, 213, 230 N.W.2d 176, 180 (1975).

Whether CON should be an adversarial rather than a consultative process, however, remains a hotly debated issue in many states, especially among providers. Opponents of an adversarial system are concerned about the length of time it would take to conduct full-blown evidentiary hearings (including rights of cross-examination) for each of the several CON cases decided monthly by the CON decisionmaker. There is also an apprehension about excessive legalism that is common not only among health providers but also among many veterans of health planning activities who were reared on the "cooperative" model of health planning and trained in methods of community organization. It is feared that a shift to full evidentiary hearings would bring conflict-oriented decisionmaking rather than the consensus-oriented model that has dominated the largely voluntary, nonprofit health care sector.³¹ It is also feared that the shift would result in a transfer of control over the health care system from the health providers and professionals to the lawyers. Proponents of the adversarial approach, on the other hand, question whether lawyers—or traditional legal process—can or should be kept out of a decisionmaking system that often involves multimillion dollar decisions, complex statutory procedures, and the future of long established, resource intensive and popularly supported institutions.

Appeals of decisions adverse to the applicant have been granted as a matter of right. Under the provisions of P.L. 93-641, an HSA also has standing to appeal a decision made by the state CON decisionmaker that is contrary to its recommendation.³² Administrative remedies are generally required to be exhausted before judicial review can be obtained, but the latter is typically granted pursuant to the state's administrative procedure act (APA). The applicability of the state's APA to the procedures of the earlier HSA review remains an unsettled legal issue. Furthermore, the standing of parties other than the proponent and the HSA to appeal a decision adverse to their interests is increasingly a matter of debate; few state CON statutes presently provide for broad standing.³³

31. "The idea was that if providers were brought together and properly informed, they would come to appreciate the mutuality of interests among them and with the communities they served. With technical assistance furnished by the planning agency, each hospital would willingly plan for its own development." Klarman, *Health Planning: Progress, Prospects and Issues*, 56 MILBANK MEM. FUND Q. 78, 88 (1978). See also Gottlieb, *Certificate of Need: Potential Threat to Planning*, HOSPITALS, December 16, 1971, at 51.

32. 42 U.S.C. § 300m-1(b)(13) (1976). See generally Dolan, *Who Has Standing to Appeal Certificate-of-Need Decisions?*, 1978 UTAH L. REV. 155.

33. See generally Dolan, *supra* note 32.

A CON generally must be exercised within specific time periods (for example, binding contracts must be entered into by the provider to commence the project within twelve months) and must be consistent with the terms of the application (for example, a piece of equipment estimated in the application to cost \$500,000 and approved on that basis should not cost the provider \$1 million at the actual time of acquisition).³⁴ A CON has been regarded as not otherwise subject to limitation after approval, however, and little monitoring is currently being done to assure compliance with the terms of the CON decision or the representations made by the project proponent in the CON application.

II. PAST APPRAISALS OF CERTIFICATE OF NEED PROGRAMS

A. *The Majority View: "A Failure"*

Despite strong advocacy of the CON program by the Carter Administration, leading senators and congressmen, and such private sector representatives as business and labor groups, insurance companies, and even provider groups themselves,³⁵ the majority view is that the program has, to date, been a failure.³⁶ The most damaging piece of evidence in support of this conclusion is the extremely high approval rate in those states with CON programs—the great majority of all projects submitted for review have been approved.³⁷ In addition, "grandfather" provisions incorporated into most state CON statutes to protect those projects already commenced from ex post facto reviews may have spurred many providers to accelerate plans for expansion prior to the law's passage, and may have even led to a rebirth of projects previously shelved by the providers themselves.³⁸

34. See, e.g., COLO. REV. STAT. § 25-3-509 (Cum. Supp. 1978).

35. State hospital associations have tended to support efforts to enact CON laws, giving rise to speculation by some observers that CON programs will result in a pro-industry anti-consumer bias helping to preserve health care cartels and protecting them from competition. See, e.g., Havighurst, *Franchising Experience from Other Industries and its Relevance for the Health Field*, in MANAGEMENT MEMORANDUM ON HOSPITAL FRANCHISING (1973).

36. See, e.g., LEWIN & ASSOCIATES, INC., EVALUATION OF THE EFFICIENCY AND EFFECTIVENESS OF THE SECTION 1122 REVIEW PROCESS (1975); Hellinger, *The Effect of Certificate-of-Need Legislation on Hospital Investment*, 13 INQUIRY 187 (1976); Salkever & Bice, *The Impact of Certificate-of-Need Controls on Hospital Investment*, 54 MILBANK MEM. FUND Q. 185 (1976).

37. A 1975 study indicated that 93% of all CON projects submitted to review in 20 states were approved. LEWIN & ASSOCIATES, INC., *supra* note 36. But see American Health Planning Association, *Selected Preliminary Results from a Survey of Health Planning Agencies: HSA Performance Under Certificate of Need and 1122 Programs* (Nov. 28, 1978) [hereinafter cited as American Health Planning Association report.]

38. The recent controversy in California regarding the passage of AB 4001 is the most visible

In states such as New York and Massachusetts, where the approval rate for CON has been lower than average and where reviews have been occurring for at least several years, the rate of health care inflation—especially in the hospital sector, the primary target of CON—continues to rise at rates substantially above the country's general inflation rate.³⁹ These findings tend to corroborate the results of a 1976 study by Bice and Salkever showing that from 1968 to 1972 (the early days of CON) the programs had no apparent effect on slowing the rate of overall hospital asset growth even though they were successfully reducing the rate of hospital bed growth. In addition, the study found a greater rate of asset growth in states with CON than in states without it. The authors concluded that hospitals were merely shifting new expenditures into areas immune from review, such as equipment and salaries.⁴⁰

Another piece of evidence pointing toward the failure of the CON system is the inconsistency of the outcomes of review⁴¹—a significant defect in a regulatory system that must be judged by standards of fairness as well as stringency. Inconsistency arises from several causes: comparable projects may be handled differently by the relatively autonomous regional planning bodies within the states (now the HSAs, previously the CHP "b" agencies), which may well possess different levels of staff competence, adopt review standards and criteria of divergent stringency and scope, and be guided by boards with differing ori-

case in point. It has been estimated that \$2.7 billion in new capital expenditures resulted from the passage of AB 4001, a much tougher state CON law than the California program it replaced. This estimate has been challenged by the official responsible for the California program, who claimed that only \$150 million could be attributed to projects "generated or accelerated" to beat the new law's deadline, although he did concede that \$1 billion in projects had been grandfathered under the law's exemption of projects that would result in "substantial economic loss" if discontinued (the lesser of \$75,000 or 10% of the project total). Letter from Saleem A. Farag, Chief, Office of Statewide Health Planning and Development, to Dr. Stuart H. Shapiro, Office of United States Senator Edward M. Kennedy (Nov. 23, 1977). See CAL. HEALTH & SAFETY CODE § 437.11(b)(3) (West Supp. 1978).

39. See, e.g., Health Care Expenditures in Massachusetts, White Paper prepared by the Health Planning and Policy Group of the Commonwealth (June 9, 1978).

40. Salkever & Bice, *supra* note 36, at 206-09. See also Hellinger, *supra* note 36, at 191-92.

41. See, e.g., North Miami Gen. Hosp. v. Office of Community Medical Facilities, 355 So. 2d 1272, 1275, 1277 (Fla. Dist. Ct. App. 1978) (final administrative decision to deny a CON for a hospital to acquire a CAT scanner reversed, in part, because a CON for a CAT scanner had been granted to another hospital in the same county during the pendency of the application in question when the same standard for review—a 2400 scan per year utilization rate—had been in place and the other facility had failed to meet the standard). See also Northwest Hosp. v. Illinois Health Facilities Planning Bd., 59 Ill. App. 3d 221, 227-28, 375 N.E.2d 1327, 1332 (1978) (denial of application for new medical/surgical and intensive care beds reversed because the standard, created by defendant for use in ruling on plaintiff's application alone, was against substantial weight of the evidence).

entations (for example, one emphasizing accessibility of care, another focusing on cost containment). The state CON decisionmaker, should it decide to defer to frequently diverse regional recommendations, then renders different final decisions on comparable projects within the state.⁴²

Temporal differences in project submission may also result in inconsistent decisions—for example, a project submitted before plans or criteria have been adopted or revised may well fare better than a comparable project submitted afterward. Similarly, a project that is submitted and approved may well be treated differently than a subsequent, comparable project if only because the first program has fully satisfied the identified need in the community for the service and the second project—however excellent the proponent's reputation for quality, cost-effectiveness and service to low-income individuals—is, therefore, regarded as redundant. This approach is consistent with precedent elsewhere in the field of law and public policy and can be defended as necessary and appropriate for a system that must not remain blindly tied to outdated approaches or allow unproductive duplication.⁴³

Political interference can lead to favored treatment and consequently to inconsistent outcomes. The most notable of such efforts has occurred in Massachusetts, where the state legislature recently passed twelve special bills to grant CONs to twelve facilities whose applications had been denied by the state agency. Governor Dukakis vetoed all twelve bills, but the Massachusetts legislature succeeded in overriding two of the vetoes.⁴⁴ Several years earlier, a Massachusetts court reviewed two special bills passed by the state legislature to grant per-

42. The likelihood of this occurring depends, of course, on the diversity of the HSAs within the state, the perceived competence and political strength of the HSA and state agency, the nature of the project, and the scope of review and appeal rights under the state CON statute. The Arizona CON law, for example, requires the state decisionmaker to adopt the HSA's recommendation unless he finds that its findings are arbitrary, capricious or not supported by substantial evidence. ARIZ. REV. STAT. ANN. § 36-433.02 (West Supp. 1978). While the Arizona law is not typical and is not in conformity with the requirements of P.L. 93-641, it does illustrate the problem in other states where the state's scope of review of HSA actions may be limited, especially when a favorable action has been taken on the CON application. See also N.J. STAT. ANN. 26:2H-1 (West Supp. 1978); Somers & Somers, *Certificate of Need Regulation: The Case of New Jersey*, in REGIONALIZATION AND HEALTH POLICY (E. Ginzberg ed. 1977).

43. See, e.g., *Saint Joseph's Hosp. v. Finley*, 153 N.J. Super. 214, 225, 379 A.2d 467, 472 (1977), cert. denied, 75 N.J. 595, 384 A.2d 825 (1978), in which the court ruled that it was "entirely within [the] power and responsibility [of the CON Board] as a continuing regulatory body, in the light of present and future considerations in the public interest," to adopt new regional regulations regarding cardiac surgery units, despite prior determinations to the contrary.

44. HEALTH BRIEFS, September 1977 (prepared by the Massachusetts Office of State Health Planning).

mission to two hospitals to expand after their CON applications had been rejected by the state agency; the court determined that the legislative actions were lawful, having violated neither the federal nor the state constitution.⁴⁵

The recent uproar in Oklahoma over the proposed Oral Roberts Hospital, in which a CON was sought for a \$250 million medical complex including a 777 bed hospital, illustrates the political issues lurking in CON reviews. In the Oral Roberts case the state CON decisionmaker, consisting of three state officials (all gubernatorial appointees), overrode the negative recommendation of the HSA after the state legislature, in the face of a massive letter writing campaign launched by Rev. Roberts, passed an unprecedented resolution supporting the project. The local HSA and several Tulsa hospitals have filed an appeal, and the decision is now being challenged in court.⁴⁶

It should be noted parenthetically that all CON decisions are inherently political since they affect the allocation of scarce resources—money, staff and status.⁴⁷ In addition, given the reviewing agency's dependence on the legislature for state authorizations and appropriations for operating expenses (even if it is only for authorization to spend federal monies already received or allocation of the twenty-five percent state match required under P.L. 93-641), it is difficult to fault the sensitivity of CON reviewers within the executive branch to the concerns of influential state legislators. Nonetheless, it is a problem in the present CON system that has contributed to the lack of effectiveness of many state programs.⁴⁸

Other inconsistencies may arise among comparable projects because of nonsubstantive differences in the quality of the project's advocacy as evidenced by the degree of professionalism of the written application or of the oral presentation submitted to the CON decisionmaker. Most of the costs incurred by a provider in developing and later presenting his CON proposal are reimbursable from patient

45. *Commissioner of Pub. Health v. Bessie M. Burke Mem. Hosp.*, 366 Mass. 734, 323 N.E.2d 309 (1975). See Weiner, *Participatory Procedure and Political Support for Hospital Cost Containment Programs: Limits of Open Administrative Process*, this Symposium, at text accompanying notes 114-27.

46. For a more complete description of surrounding events, see *NEWSWEEK*, May 8, 1978, at 43.

47. See text accompanying notes 127-49 *infra*.

48. The 1978 session of Congress considered, but did not introduce, amendments to P.L. 93-641 that would have withheld federal financial support from health programs in states where the legislature explicitly overrules an administrative CON decision; such an approach, however, would do little for situations in which political pressures are used more subtly.

sources, including public and private third-party payors. This fact tends to reward large urban facilities and penalize smaller rural facilities that have less access to consultants, a greater hesitancy to utilize "outsiders," and a smaller allocation of overhead funds that can be used at the institution's discretion.

Prior to 1975, many regional health planning bodies received direct financial support from providers and provider associations—the very institutions whose projects they were required to review under CON. The possibility thus arose for favored, inconsistent and obviously inappropriate reviews. Provisions of P.L. 93-641 now specifically prohibit CON review and health planning agencies from receiving such "tainted" money.⁴⁹

In contrast to Bice and Salkover's examination of outcomes under CON, studies by Lewin and Associates examined CON procedures, structures and standards utilized in decisionmaking and found significant defects throughout the system.⁵⁰ Relatively few CON matters have reached the courts, but of those cases reported, several judicial decisions, based on findings of procedural irregularities, have resulted in reversals of CON decisions made at the administrative level. The most cited procedural errors have been the failure of the state CON reviewing agency to develop an adequate adjudicatory or rulemaking record⁵¹ or to promulgate procedures and standards pursuant to the state's APA.⁵² Some courts have also struck down CON decisions on

49. 42 U.S.C. § 3001-1(b)(5) (1976).

50. LEWIN & ASSOCIATES, INC., *supra* note 36; LEWIN & ASSOCIATES, INC., EVALUATION OF NEW YORK STATE'S CERTIFICATE OF NEED PROGRAM (1977).

51. See *North Miami Gen. Hosp. v. Office of Community Medical Facilities*, 355 So. 2d 1272, 1275 (Fla. Dist. Ct. App. 1978), in which the court found that the CON review standard of 2400 CAT scans per annum was not supported by "sufficient, competent and substantial" evidence.

52. See *Nebraska Methodist Hosp. v. Casari*, [1978 Transfer Binder] MEDICARE & MEDICAID GUIDE (CCH) ¶ 29,205 (D. Neb. Aug. 18, 1978), in which the disapproval of a \$28 million project by the CON agency (in this case the Designated Planning Agency under the 1122 program) was struck down because the agency had failed to promulgate valid regulations pursuant to state law. The court rendered this ruling even though the state agency had issued rules (though the state's APA had not been complied with) and was conducting the 1122 program pursuant not to any state law but in accord with a contract with the federal government. The court stated that the "federal government cannot authorize a state agency to act where it could not otherwise act." *Id.* at 10,306. But see *St. Joseph's Hosp. v. Finley*, 153 N.J. Super. 214, 379 A.2d 467 (1977), *cert. denied*, 75 N.J. 595, 384 A.2d 825 (1978). The *Casari* ruling may be in conflict with the Supreme Court's decision in *North Carolina ex rel. Morrow v. Califano*, 435 U.S. 962 (1978), which upheld the constitutionality of CON even as applied to a state where CON had been earlier ruled unconstitutional. See also *In re Certificate of Need for Aston Park Hosp., Inc.*, 282 N.C. 542, 193 S.E.2d 729 (1973). Furthermore, the court's ruling in *Casari* that no 1122 program can be implemented in a state until valid state regulations are promulgated is highly questionable; no other court has so

substantive grounds, specifically because of inconsistent treatment of comparable projects.⁵³

Other concerns about CON have been raised, and although largely undocumented at the present time, they warrant a brief mention. CON staff have been described as underpaid and underutilized, with a high turnover rate, as exemplified, perhaps not suprisingly, by the Massachusetts experience in which there were four CON administrators during a recent three-year period.⁵⁴ Further, it was anticipated that CON would stifle innovation and result in cartelization of the health system;⁵⁵ however, no evidence has been adduced showing that health maintenance organizations (HMOs), out-patient surgicenters, or other innovative services have been prejudicially treated.⁵⁶ Finally, compliance with the CON process itself has been called inflationary because of the costs incurred in preparing and presenting a competent and comprehensive application.⁵⁷ As discussed above, costs incurred for such a purpose can be sizable (\$5,000 to \$10,000 is a recent estimate in Colorado), but they are reimbursable and are thus ultimately picked up by consumers and taxpayers.

B. *The Minority View: "A Limited Success"*

The supporters of CON have been less effusive in praising the program than the critics have been vehement in damning it. Supporters believe that during the last two years there has been a substantial improvement in the quality and results of the program. They also believe that many of the program's recent successes still cannot be quantified.⁵⁸

held since the 1122 program began in 1972. The decision has, nonetheless, prompted emergency rulemaking in at least one state, Colorado.

53. See note 41 *supra*.

54. Medeiros, *Long Range Institutional Plans and Budgets: Can They Provide a Vehicle for Anticipatory Strategies?*, in *LINKING HEALTH PLANNING AND REGULATION TO INCREASE COST EFFECTIVENESS* 14 (M. Sweetland & K. Bauer eds. 1977).

55. See, e.g., Havighurst, *supra* note 10.

56. See, e.g., LEWIN & ASSOCIATES, INC., *supra* note 36. See also text accompanying notes 103-04 *infra*.

57. D. KINZER, *HEALTH CONTROLS OUT OF CONTROL* 97 (1977).

58. See, e.g., Remarks of Joseph A. Califano, *supra* note 17, at 7-10. See the American Health Planning Association report, *supra* note 37, at 1-2, which cites an approval rate of 75% for all capital investment among those 134 of 203 HSAs surveyed (covering approximately 60% of the population), with alleged savings of over \$1 billion during 1976-1978. It is important to note, however, that the statistics covered not only formally submitted and finally determined projects but also "unofficial though documentable actions which led to the withdrawal or non-submission of CON/1122 applications." *Id.* The study is, by the admission of its own authors, very preliminary: its base data has not been verified; it covers neither the full universe of HSAs nor state agencies; no verification has been performed on the category labelled "unofficial but document-

Other proponents assert that CON has improved institutional planning within those facilities subject to its jurisdiction.⁵⁹ Many health institutions have underdeveloped internal planning capabilities and would clearly benefit from any program that required them to better define their present and future goals and objectives. Such internal planning may become increasingly necessary to justify a provider's CON applications and may help to rationalize a desired project in terms of established community goals. These planning efforts may also be useful to the facility in determining a tactically appropriate response to a CON application from a local or regional competitor.⁶⁰

Finally, CON has been said to serve as a forum to make the general public, large purchasers of health care such as labor trust fund directors and corporate employee benefit managers, and the news media more aware of the forces driving up health care costs. This increased cost consciousness would result, it is argued, from bringing the reasons for and implications of expansionist health decisions out of the private boardroom of individual health institutions and insurance companies and into a public decisionmaking forum.⁶¹

III. AN ASSESSMENT OF CURRENT CERTIFICATE OF NEED PROGRAMS

In P.L. 93-641 Congress attempted to spur the development of new state CON programs and the improvement of existing programs. Congress has also shown interest in amending federal legislation to ameliorate problems that continue to exist. But while the lure of federal dollars may have induced some improvement of the nation's CON programs, the inherent structural problems to be discussed in this section indicate that without substantial reform the prospects for effective CON efforts will remain dim.

The increase in federal funding to HSAs and state agencies under P.L. 93-641, and the prohibition against provider financial support to these agencies, may help assure more professional staff and end the

able" regarding withdrawn or never-submitted projects; and, most importantly, it fails to examine, as Bice and Salkever would require, whether the overall level of capital resources flowing into the hospital sector has stabilized or declined. See Salkever & Bice, *supra* note 36.

59. AMERICAN HOSPITAL ASSOCIATION, *THE PRACTICE OF PLANNING IN HEALTH CARE INSTITUTIONS*, 83-86 (1973). See also Peters, *L-R Planning May Direct Change*, *Impact*, December 26, 1978 (newsletter published by PACT Health Planning Center, Denver, Colorado).

60. See generally Medeiros, *supra* note 54, at 13-17.

61. See, e.g., Remarks of Joseph A. Califano, *supra* note 17, at 10.

"strings attached" funding for many regional CON agencies. Requiring facilities actively to explore "less expensive alternatives" and, as a precondition to granting a CON for projects involving in-patient services, forcing the CON decisionmaker to make written findings in as many as ten areas, should also prove beneficial in strengthening the CON process.⁶² The emergence of the various plans⁶³ required under P.L. 93-641 may prove useful in conducting CON reviews, but only if they are of good quality—a very uncertain prospect.

Inadequate plans will only serve to bolster the CON cases of underserving applicants. If the plans are too generous, they will tend to show an inappropriate need for a project; if the plans are overly stringent, they may be attacked as arbitrary, capricious and lacking a rational basis and will generate sympathy for the CON applicant unless technical support for the plan can be summoned. This recently occurred in a Florida case involving the denial of a CON for a CAT scanner.⁶⁴ In denying the hospital's application the state CON reviewers invoked a utilization guideline of 2,400 scans per year for CAT scanners, a guideline recommended by the federal government.⁶⁵ A Florida appellate court reviewing the decision ruled not only that no rulemaking record had been developed by the CON agency to indicate whether any serious agency consideration had been given to the reasonableness of the utilization standards or their suitability to the proposed service area (the city of Miami) but also that use of the standard as the sole review criterion was inappropriate. Consequently, the court ruled in favor of the hospital and granted it the CON even though there were several scanners operating at less than capacity within a five mile radius of the hospital, far more than is generally thought appropriate.⁶⁶

Moreover, given the general experience to date of inadequate consumer involvement and pervasive provider influence (if not de facto domination),⁶⁷ it is doubtful that the system being developed under the terms of P.L. 93-641 will provide the balanced political support needed

62. 42 C.F.R. § 123.410 (1977).

63. See text accompanying notes 86-107 *infra*. See also Atkisson & Grimes, *Health Planning in the United States: An Old Idea with a New Significance*, 1 J. HEALTH POL. POL'Y & L. 295 (1976).

64. North Miami Gen. Hosp., Inc. v. Office of Community Medical Facilities, 355 So. 2d 1272 (Fla. Dist. Ct. App. 1978).

65. *Id.* at 1275.

66. *Id.* at 1276-77.

67. See, e.g., Texas Acorn v. Texas Area 5 Health Systems Agency, Inc., 559 F.2d 1019 (5th Cir. 1977); Vladeck, *Interest-Group Representation and the HSAs: Health Planning and Political Theory*, 67 AM. J. PUB. HEALTH 23 (1977).

for an effective CON process. In fact, the multiple levels of review required by the federal planning law may well have the effect of diminishing the quality and rigor of the final analysis.⁶⁸

Finally, the increased functions of HSAs and state planning agencies required by the federal law will probably harm the process, rather than aid it, by significantly increasing the workload for CON reviews in a system that is generally unable to handle competently its current workload in an expeditious fashion.

If CON is to be an effective tool for cost-containment, additional changes to the CON mechanism must go beyond those presently embodied in P.L. 93-641 or now being considered as amendments. A reformed CON system must be capable of responding to the causes of health care inflation in a practical and effective fashion, recognizing the structural defects in the health care industry, the industry's political power, the American penchant for convenience and the latest in technology, and the currently prevailing mistrust of government and regulation. Without these basic reforms, the CON mechanism will have little, if any, impact on rising health costs.

A. The Current CON Process Is Too Reactive

Virtually by definition, CON is a passive and reactive mechanism. Under the current system, projects are conceived, developed and submitted by proponents who are under little, if any, obligation to confer with other interested parties—whether other institutional providers, cost-containment watchdog groups, public and private quality assurance agencies, third-party payors, or the CON review agencies. Because of the relatively short period of time (90 days)⁶⁹ generally allowed as the maximum for conducting all stages of a CON review (at the level of the sub-HSA, if any, HSA and state), once the project has been submitted and found to be “complete,” there is precious little time for other interested parties to mobilize—first, to decide whether to evaluate the project for its potential impact on their concerns or self-interest, then to conduct an adequate analysis of the proposal and, possibly, compare that study with any performed by other interested parties, and finally to submit the appraisal to the reviewing agencies at a point early enough in the review cycle to be useful. For projects commonly six months to two years in the making and hundreds of pages or more in

68. See text accompanying notes 165-79 *infra*.

69. 42 C.F.R. § 122.306 2(ii) (1977).

length, the fifteen to forty-five days generally available to carry out all these tasks is frequently inadequate, even if resources could be found to conduct such reviews.

This lack of sufficient time to respond is undoubtedly one reason for the predominance of "logrolling" among providers (the "I support your proposal, you support mine" syndrome) even when a specific project, if approved, could substantially injure the interests of a neighboring facility. The failure of providers to be actively involved in the review of applications from potential competitors denies the CON reviewers valuable information that may be available only from another health care provider in the community. It also tends to create a difficult political environment in which a project may receive wide ranging support far beyond its own intrinsic merit. The "batching" of several similar projects for CON review for the purpose of approving only one is now regarded as an important tactic for breaking up this "logrolling syndrome."⁷⁰

Another problem resulting from the reactive nature of the CON process is that capital expenditures in the health field are initiated by health providers, who often respond to their own institutional imperatives rather than to the needs of the community they serve.⁷¹ Consequently, CON review staffs spend much of their time on projects that are not developed to address the priority health needs of people in their service area—which should be the primary focus of their planning efforts. Had the resource development provisions of P.L. 93-641 (Title XVI), which were designed to replace the old Hill-Burton program, been funded by Congress, the reactive nature of the CON mechanism might have been lessened. While in most states CON may now represent the primary means of assuring public accountability of health care development, it is a negative control, not a positive one. A complementary affirmative planning mechanism is sorely needed.

B. Few Incentives Exist to Support a Rigorous CON Decisionmaking System

If CON decisionmaking were an exact science, the lack of incentives and support mechanisms for rigorous decisionmaking might be less important because CON decisions, however unpopular, could be objectively verified and thus shielded, at least to some degree, from the

70. See text accompanying notes 150-55 *infra*.

71. See, e.g., L. RUSSELL, *TECHNOLOGY IN HOSPITALS* 8 (1978).

pressures of influential groups. CON decisions, however, like many other public policy matters, are based on imperfect information, unproven hypotheses, and best guesses about outcomes. Consequently, they are subject to second-guessing and criticism—not all of which is constructive in either intention or effect.

CON decisionmakers presently have few incentives to say “no.” Second-guessing of CON decisions is commonplace, not only through the filing of administrative and judicial appeals, but through contacts with elected officials—both spontaneous and orchestrated—from an institution’s medical and administrative staff, its trustees, and the community it serves. Despite the popular rhetoric about consumer power, most consumers, no matter how much they may complain about rising health costs in the abstract, sympathize with the expansionist tendencies of their local hospital rather than with the cost-containment concerns of the CON reviewers.⁷² Unless there is well-organized support from business or labor, as there has been in such cities as Detroit, Cincinnati and Rochester,⁷³ or a crisis involving the budget of a state because of accelerating Medicaid expenditures, as in New York and Massachusetts,⁷⁴ reviewers are loathe to deny CON applications in all but the most clear-cut cases. This reluctance exists at both the HSA level, where the activities of the chiefly private nonprofit agency require consensus, voluntary compliance, and support from the diverse provider community, and at the state level, where the threat of legislative or gubernatorial retaliation against the agency’s budget or personnel may arise when a politically unpopular CON decision receives attention.

Finally, given the passive and open-ended nature of CON and the self-doubt fostered by the use of imperfect data and imperfect evaluation tools in decisionmaking, there is little incentive for a reviewing agency to persevere and deny an application in the face of its own lingering uncertainty about the need for a project. These constraints become even more powerful when political pressures are delivered or anticipated from influential interest groups and when there is little opportunity for the CON reviewers to believe that the funds at issue—if denied in a particular case—would be redirected into a more appropriate health service project.⁷⁵

72. LOUIS HARRIS POLL, *supra* note 11, at 56.

73. See note 111 *infra*.

74. See note 142 *infra*.

75. For an analysis of how a similar lack of incentives affects the operations of another health

C. CON Programs Suffer from Lack of Accountability, Redundancy of Function, and Confusion over the Appropriate Role for Staff

P.L. 93-641 has been applauded for its adherence to the principles of "bottom-up" planning. HSAs, unlike their predecessors, the CHP "b" agencies,⁷⁶ have the right to review CON projects and recommend approval or disapproval.⁷⁷ This language seems to contrast sharply with the "review and comment" responsibilities of the CHP "b" agencies.⁷⁸ In reality, however, HSA actions on CON applications may, depending on the provisions of the specific state law, be little more than advisory opinions for the state CON reviewing agency, which may conduct its own de novo review regarding the finding of facts and the application of law, health plans, standards and criteria relevant to the project.

In the case of a disagreement, the HSA has the right to receive from the state an explanation why its recommendation was not followed and to appeal from an adverse state action, assuming the agency possesses the financial resources to prosecute an appeal.⁷⁹ This is likely to be a rare event because most HSAs may well decide to spend their limited resources in other ways and would also be reluctant to antagonize the state health planning and development agency (SHPDA), an agency with which the HSA has repeated dealings, and with whom the HSA is likely to seek to remain on good terms.⁸⁰

Sub-area councils, if they exist in a health service area, stand, for purposes of CON review, in the same relationship to the HSA as the HSA does to the SHPDA except that they lack any statutory basis and are without any appeal rights under P.L. 93-641. Nevertheless, in some jurisdictions they also conduct reviews of pending CON projects, fre-

regulatory agency, the PSRO, see Blumstein, *Inflation and Quality: The Case of PSROs*, in *HEALTH: A VICTIM OR A CAUSE OF INFLATION?* 245, 283-84 (M. Zubkoff ed. 1976).

76. Comprehensive Health Planning and Public Health Services Amendments of 1966, Pub. L. No. 89-749, 80 Stat. 1180 (codified in scattered sections of 42 U.S.C. (1976)).

77. National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, § 1513(f), 88 Stat. 2225 (1975) (codified at 42 U.S.C. §§ 300k-300t (1976)).

78. Comprehensive Health Planning and Public Health Services Amendments of 1966, Pub. L. No. 89-749, 80 Stat. 1180 (codified in scattered sections of 42 U.S.C. (1976)).

79. 42 C.F.R. § 123.409(a)(9) (1977).

80. H. FOLEY, A REPORT ON THE CURRENT DEVELOPMENTS IN THE NATIONAL HEALTH PLANNING PROGRAM 14-15 (1978) ("The health planning act intended strong state and local participation in the planning process. We currently see a need for an even stronger role for the states.") (comments of Dr. Henry A. Foley, Administrator of the Health Resources Administration, to the National Council on Health Planning and Development).

quently holding hearings and rendering decisions based on their findings of fact and their applications of law, plans, standards and criteria. Their work, however, is only advisory to the HSA, whose decisions are, in turn, only advisory to the SHPDA.

Clearly, some economy must be brought to this system. If there were a single hearing before the final CON decisionmaker, lay reviewers could take their responsibility more seriously, the work of professional staff could be better focused and less overlapping, providers would complain less of redundant review procedures and their attendant costs, and interested parties, including community and consumer groups, could better concentrate their efforts. As the system is presently structured, concerned members of the public risk having their time and energies drained by the plethora of meetings, hearings and discussions now common to the CON system. Thus, the field is effectively left open only to the professional advocates and lobbyists whose job it is to attend all such meetings.

The present multiplicity of hearing levels also increases the possibility of inconsistency of findings among the reviewing agencies, especially since in most states no findings are binding upon subsequent reviewers until after the state level review. Even at the state level, appeals from the primary CON decisionmaker may, in some states, give rise to a full *de novo* review. Such inconsistencies may not only provide the basis for the filing of dilatory appeals, but also tend to undercut the apparent legitimacy of CON decisions; this is especially true of those CON actions that reject particular applications,⁸¹ which under present state laws and judicial interpretations of standing constitute the great preponderance of CON appeals.⁸²

Another problem with the current CON system is the lack of a clear control point. The SHPDA is responsible for the final administrative decision, but it possesses no direct administrative control over the HSAs or any sub-area councils. HSAs are funded directly by HEW; funds are not channeled through the state agency.⁸³ The concerns about HSA performance expressed by HEW have related primarily to grants management and requirements for HSA structure and procedures. Outcomes of performances have rarely been examined by

81. See *Northwest Hosp. v. Illinois Health Facilities Planning Bd.*, 59 Ill. App. 3d 221, 375 N.E.2d 1327 (1978).

82. See generally Dolan, *supra* note 32. Four states (Hawaii, Illinois, Minnesota and Washington) restrict appeals to denials only. *Id.* at 162 n.36.

83. 42 U.S.C. § 300f-5 (1976).

HEW in monitoring the activities of HSAs, especially in the regulatory review areas. In addition, HSAs are unable or unwilling to alter the performance of sub-area councils (where they exist), usually claiming that the tenets of P.L. 93-641 require, at least in theory, bottom-up planning.

The Statewide Health Coordinating Council (SHCC) is made up of between thirteen and eighty-three members. In most states, it meets several times a year, is composed of volunteer members, and is staffed by the SHPDA, though it usually also receives continuing input from HSA staff members (sixty percent of the SHCC membership is nominated by the HSAs).⁸⁴ This unwieldy structure and procedure makes it possible, even under the best of circumstances, for the SHCC to perform only its most fundamental assignments, such as providing advice to the SHPDA and making only the most general policy decisions. It is not an agency for resolving difficult questions regarding the operations of a regulatory system, such as the reasonableness of deadlines, the adequacy of review criteria, the quality of available health data, or the appropriate division of functions between competing state and regional bodies. In addition, HEW recently determined that the SHCC should not serve as the CON appeal body.⁸⁵

This confusion over who is in charge makes it exceedingly difficult to manage, let alone reform, the system. The interested agencies themselves have no adequate place to resolve their differences, for even the state legislature lacks sufficient jurisdiction over the federally funded and federally accountable HSAs. The SHPDA that is nominally in charge of the CON program has no real control over the HSA, for it exercises no control over the HSA's budget, the hiring of its staff or the actions of its board of directors.

The absence of an administrative focus also makes it difficult for reformers outside the system, provider representatives or other government officials to fix responsibility for deficiencies in the program and initiate appropriate corrective measures when necessary. Of course, this lack of a locus for accountability can also feed the inherent bureaucratic tendency of CON agencies and HSAs to shift blame and deny responsibility for defects in the system.

Another troublesome aspect of CON programs is the uncertainty

84. See generally H. FOLEY, *supra* note 80, at 7, 15.

85. See Halpern, *The Statewide Health Coordinating Council: Can It Work?*, HEALTH L. PROJECT LIB. BULL., March 1979, at 99, 102.

over the appropriate role of CON review staff. Should staff be used strictly in evaluation or should it be engaged in negotiation with the applicant? If the latter, should negotiation take place concurrently with the evaluation, prior to it, or subsequent to it? Should staff be limited only to technical evaluation or should it, in the all too common case when there is no effective local constituency for cost-containment, also engage in soliciting support for staff findings emphasizing cost-containment from third party payors, large purchasers of health care, or consumer groups? These are certainly not easy issues, but they must be asked and answers must be sought—if only to generate a code of ethics for CON reviews that will help guide the reviewers and protect them from the collateral attacks of providers and consumers over their action or lack of action in bargaining for project alterations or in stimulating discussion and commentary regarding specific projects.

D. Certificate of Need Lacks the Technical Tools Needed to Perform Effectively

According to its sponsors, one of the primary advances of P.L. 93-641 over predecessor health planning programs was to be the increased emphasis on developing "state of the art" health plans of high quality.⁸⁶ The development of these plans would be made possible by providing the planners with the necessary resources, such as access to PSRO data sources. Adequate salaries would be paid to help the agencies recruit competent staff, including those with backgrounds in economic analysis, public administration and law; regional centers would be established to provide technical assistance to SHPDA and HSA staff and board members.⁸⁷ Federal guidance in plan development was to be provided through the promulgation of National Health Planning Guidelines and through closer federal supervision of local and state planning efforts.⁸⁸ Finally, by linking the quality of the agency's plans to its prospects for survival (designation status, level of funding, etc.⁸⁹), P.L. 93-641 sought to establish a strong incentive system for HSAs and SHPDAs to commit the necessary resources to perform satisfactorily in the plan development area. The intent was clear: plans were to be com-

86. See Zwack, *Initial Development of National Guidelines for Health Planning*, 93 PUB. HEALTH REP. 407, 408-10 (1978). But see text accompanying notes 67-68 *supra*.

87. See Klarman, *Health Planning: Progress, Prospects, and Issues*, 56 MILBANK MEM. FUND Q. 78 (1978).

88. See *id.*

89. See *id.*; Zwack, *supra* note 86.

prehensive and of high quality. Having been ratified by the public in an elaborate scheme of public hearings required under the law, they would provide a legitimate basis for the more controversial regulatory decisions that would follow—most notably those made by CON programs. In practice, however, health plans are unlikely to be timely enough, sufficiently comprehensive, or of high enough quality to be determinative in regulatory reviews. In some regions they may be useful, but they will not suffice as the sole or, in many instances, the predominant criteria for evaluating the merits of a proposed CON project. This is true for several reasons. P.L. 93-641 mandates a plethora of plans, but it does not require that a proposed CON project be included in any one of them as an absolute precondition to consideration. The initiative in the system still rests with the providers (the prospective applicants) rather than with the planners and CON reviewers. Hence, even in theory, P.L. 93-641 does not seek to impose a centralized planning structure on the health care sector.

The absence of centralized planning has significant implications for CON. Because projects submitted for CON review are of a wide variety and under the present law may be submitted at any time, effective plans must be comprehensive (that is, cover all possible CON applications including specific services and pieces of equipment) and must be continuously revised to remain current. Even the optimistic framers of P.L. 93-641 never intended a planning staff large enough to develop documents of sufficient breadth to cover all eventualities, nor did they anticipate that revision would be undertaken frequently enough so that all new developments in service delivery or equipment innovation could be covered.

It can be argued that in any market or mixed economy such as that of the American health care sector, plans may still serve useful social purposes even though they are passive and lack comprehensiveness. They can identify areas requiring attention, establish specific goals to address the problem areas, indicate strategies for goal attainment, and set standards to determine when the goals have been reached. No matter how useful these limited plans may be, however, they do not constitute a blueprint for CON decisionmaking as some supporters of P.L. 93-641 had hoped.

Of perhaps more immediate significance is the poor quality of the current set of health plans. The first generation of documents produced by the nation's HSAs—the Health Systems Plans (HSPs) and the An-

nual Implementation Plans (AIPs)—have been roundly criticized by their own sponsor, HEW, as well as by assorted consumer organizations. The plans have been characterized as long on description and short on analysis, advocating few, if any, prescriptions for useful initiatives, and possessing weak review criteria for purposes of such regulatory programs as appropriateness review, ratesetting and CON.⁹⁰

Nearly four years into the implementation of P.L. 93-641—itself largely a continuation of the comprehensive health planning (CHP) program of seven years' duration⁹¹—it is difficult to believe that the planning efforts under P.L. 93-641 will show any sign of marked improvement in the near future. In fact, it is sadly characteristic of governmental planning programs in America—whether in health, social services or environmental matters—that document quality is almost uniformly poor.⁹²

The reasons for the poor quality of the planning documents have yet to be carefully analyzed. It is clear that the state of the planning art is still primitive and that the concept of medical need has not yet been satisfactorily defined.⁹³ The inadequacies of health planning staff have long been suspected, although all available data indicate a relative improvement in education levels, experience and tenure of current personnel compared to those who had worked in CHP programs. Also cited have been the cumbersome multi-level board structures and procedures of P.L. 93-641, which lead to mediocre results when consensus-building efforts take priority over analytic rigor, an approach labelled in Colorado as the "least common denominator" method of planning. Instances of poor supervision of the planning effort by the federal government have also been admitted by federal spokesmen, including con-

90. An HEW Region VIII memorandum, April 20, 1977, found that "submitted HSPs and AIPs lacked the clarity and specificity to serve as the basis for the review decisions which a fully designated agency must make (e.g., Certificate of Need, Proposed Use of Federal Funds, etc.). In addition, the submitted plans failed to provide the level of specificity to serve as the foundation for the State Health Plan and The State Medical Facilities Plan."

91. Of 205 HSAs, 106 had been CHP "b" agencies. Implementation of National Health Planning & Resources Development Act of 1974, [1978] 3 MEDICARE & MEDICAID GUIDE (CCH) ¶ 29,405.

92. See generally Rein, *Social Planning: The Search for Legitimacy*, 35 J. AM. INST. PLANNERS 233 (1969).

93. For a description of the technical and conceptual problems inherent in a health plan development, see Bachman, *Health Planning—The Next Step*, 3 HEALTH L. PROJECT LIB. BULL., Dec. 1978, at 1. See also Medeiros, *supra* note 54, at 13-15; Somers & Somers, *supra* note 42, at 164; Wagner, *Criteria for Project Review*, 1 AM. J. HEALTH PLAN. 11 (1977).

tradictory directives, impractical work cycles, and overlapping plans.⁹⁴ Finally, as indicated above, there continues to be confusion over who is in charge of planning efforts within the state—the HSAs, the SHPDA, or the SHCC.⁹⁵

Three additional deficiencies have greatly hampered effective planning and CON efforts. The first deficiency is the lack of a national technology assessment capability through which the efficacy and efficiency as well as safety of new medical technology can be tested and evaluated before proliferation. The second is the lack of quality of care data on a provider-specific basis. The third deficiency is the lack of population-based data, including utilization data.

In floor debate on the proposed 1978 amendments to P.L. 93-641, Senator Edward Kennedy estimated that the acquisition and utilization costs of new technology and equipment accounted for approximately fifty percent of the annual increase in hospital costs.⁹⁶ Despite the increasing importance during the past ten years of these “creeping intensity” factors for hospital inflation,⁹⁷ governmental scrutiny is only now beginning to include technology-related considerations that go beyond issues of safety (whether the device or procedure will do any harm) to address questions of effectiveness (will it do it faster and cheaper than what is already on the market) and efficacy (will it improve patient

94. There is some indication that in developing plans, the paper planning process sometimes takes over from the substance. And some HSAs submitted plans calling for what they knew we wanted. Much of this, I believe, has to do with our lack of a well thought out communications program from the Central Office through the Regions to the HSAs.

H. FOLEY, *supra* note 80, at 5. See also Zwick, *supra* note 86.

95. See, e.g., U.S. Comptroller General's Report to Congress on the Implementation of the National Health Planning and Resources Development Act of 1974. This report attributed the difficulties encountered by HSAs in developing plans to such problems as the “unavailability of health data and national standards and criteria for the health care system, inability to recruit staff, conflicts between local and state planning agencies over their respective responsibilities . . . and delays in receiving technical assistance.” [1978] 3 MEDICARE & MEDICAID GUIDE (CCH) ¶ 29,405.

96. 124 CONG. REC. S11,905 (daily ed. July 27, 1978) (remarks of Sen. Kennedy).

97. In a December 1978 conference on medical technology sponsored by the Urban Institute in West Palm Beach, Florida, Dr. Hal Cohen, Executive Director of the Maryland Hospital Commission, cited a recent report by McKinsey and Company, Inc. that indicated that from 1974 to 1976 hospital cost per capita in the United States rose 7.9% faster than the cost of living. The McKinsey report broke down the 7.9% increase as follows: 1.6% for hospital wage increases above cost of living; 1.7% for more labor per “patient day equivalent”—a measure that includes a weighting for outpatient activity; 4.4% for real non-labor cost increase per patient day equivalent; and 0.1% for more patient day equivalents per capita. The report identified the components of the 4.4% increase as constituting supplies and equipment associated with doing more tests and other ancillary activities per patient day—what Cohen labelled “Creeping Intensity.” H. Cohen, Information Needs in the Public Sector 9 (December 1978) (copy on file in the office of the North Carolina Law Review).

outcomes).⁹⁸ Concurrently, the subject matter focus is also beginning to reach beyond pharmaceuticals to small medical devices⁹⁹ and, more recently, to larger institutional-based medical equipment like CAT scanners¹⁰⁰ and procedures like fetal monitoring.¹⁰¹

The lack of facility-specific quality of care data has been very damaging. Without this information, health planners and CON reviewers can, in the midst of the current anti-inflationary campaign, be accused of engaging in blind budget-cutting without regard to quality or, alternately, of simplistic, rigid planning evidenced by a mechanistic application of formulas (for example, "X" number of open-heart surgical procedures per year equals good care). If they are sensitive to such charges, CON reviewers and planners may, in some cases, overcompensate and misinterpret the nature of a project, in the mistaken belief that quality of care considerations, rather than the imperatives of institutional economics (such as providing a profitable service like alcoholism treatment) or of institutional politics (such as accommodating the medical staff's desires for convenience or the latest technology), are prompting the submission.¹⁰²

Furthermore, the lack of quality of care data can place CON reviewers in a difficult position when reviewing innovative projects that, if approved, would inject a competitive alternative—a real freedom of choice—into the health care system of a community. Such projects are frequently resented by the established health care providers of the community, and quality of care is customarily the reason given publicly to justify this opposition. Now that anticompetitive practices of profes-

98. See generally A. COCHRANE, *EFFECTIVENESS AND EFFICIENCY* (1972).

99. See generally Iglehart, *supra* note 12.

100. See OFFICE OF TECHNOLOGY ASSESSMENT, *POLICY IMPLICATIONS OF THE COMPUTED TOMOGRAPHY (CT) SCANNER* (1978).

101. See H. BANTA & S. THACKER, *THE PREMATURE DELIVERY OF MEDICAL TECHNOLOGY: A CASE REPORT* (1978), in which the authors assert that the uncertain benefits of electronic fetal monitoring, and its associated costs (more than \$300 million annually) and risks (including a likely increase of 100,000 Caesarian sections per year with accompanying risks to the mother of death and pelvic infections) do not seem to justify the technique's widespread use.

102. For a recent study indicating that adoption of technology often appears unrelated to medical need, see L. RUSSELL, *supra* note 71, at 173, 175-76 in which the author observed that adoption of cobalt therapy, electroencephalography, open-heart surgery and renal dialysis occurred faster in areas in which the level of insurance coverage was higher and proceeded more rapidly as that level grew. Further, she found that these technologies were more likely to be adopted in such areas than in those areas with a higher incidence of related diseases. See also J. CROMWELL, P. GINSBERG, D. HAMILTON & M. SUMMER, *INCENTIVES AND DECISIONS UNDERLYING HOSPITALS' ADOPTION OF MAJOR CAPITAL EQUIPMENT* (1975).

sional trade associations are coming under increasing scrutiny,¹⁰³ tactics such as the denial of hospital staff privileges to physicians affiliated with an alternative delivery system are no longer available. Participating in the CON process may become a legally sanctioned substitute tactic. This is true in Colorado, where, despite the general reluctance of providers to contribute to the public debate over specific CON projects, providers often break their silence when an innovative project is submitted for CON review.

One Colorado example is especially noteworthy because a pivotal issue in the deliberation—and the issue seized upon by the local physicians—was the quality of care offered by the applicant. The project being proposed was a for-profit ophthalmologic clinic that would perform certain kinds of cataract surgery on an out-patient basis in competition with the local hospital. The owner of the clinic was also the surgeon who would be performing the operations. Despite the doctor's international recognition for his pioneering work in ophthalmological surgery and his years of practice at the local hospital without any apparent problems, allegations were made, without further documentation, that the clinic might provide an inferior quality of care. In the absence of data, allegations were traded between the proponents of the clinic and those of the hospital. Notwithstanding a positive recommendation by the HSA's staff, the HSA voted to recommend denial of the project. Then, after lengthy debate at the state level, the HSA recommendation was rejected and the CON was granted.

The unavailability of data on the quality of care issue in that case was of crucial importance. Had it been available, it could have been used to compare the performance of the would-be clinic owner with that of his former colleagues at the hospital and his peers elsewhere in Colorado (if not the nation), and it could have been used to evaluate the performance of comparable clinics elsewhere in the nation vis-à-vis the care being rendered in hospital settings for the same type of patient and care. Some of the data in question—at least the portion pertaining to the hospital-based activities—had already been collected by the local PSRO. Because of current federal policy, however, that data was not available to the CON decisionmakers,¹⁰⁴ and comparable data is not

103. See Iglehart, *supra* note 19. See also Havighurst, *Professional Restraints on Innovation in Health Care Financing*, 1978 DUKE L.J. 303.

104. HEW Proposed Rule on Confidentiality and Disclosure of Professional Standards Review Organization (PSRO) Information, 44 Fed. Reg. 3058 (1979). But see *Public Citizen Health Research Group v. Department of Health, Education and Welfare*, [1978 Transfer Binder] MEDI-

collected or available through other sources.

Making decisions in such cases without adequate data is not only difficult and potentially risky for the decisionmaker, but it is, simply speaking, bad decisionmaking. Obviously, rational decisions require information, especially when the decisionmaking process becomes subject to increasing political pressures as is now occurring in the health care industry. That some of the information necessary for a viable CON program has already been collected means that the task is less monumental than some believe. The data, however, must be made available or else the public will be forced to assume the cost of a duplicative collection effort.¹⁰⁵

The lack of good demographic data is also of critical importance because sound population estimates and projections, including those relating to rate of growth, and a population's anticipated racial, age and socio-economic characteristics and its rates of mortality and morbidity, have great import for future planning decisions. Given the dynamic nature of community populations and the rapid change in health delivery systems, health planning cannot be based on a static model.¹⁰⁶ Absent definitive population projections, poor decisions will be made, and they will be subject to well-deserved criticisms. Finally, population-based utilization rates can be far more instructive regarding problems in the delivery system than facility-based rates. Epidemiological studies of health services utilization is a critical tool for an intelligent health planning and regulatory system. Results from these studies can indicate excessive utilization and surplus resources in com-

CARE & MEDICAID GUIDE (CCH) ¶ 28,943 (D.D.C. Apr. 25, 1978), in which Judge Gesell of the United States District Court for the District of Columbia ruled that PSROs were "public agencies" within the meaning of the federal Freedom of Information Act (FOIA) and therefore were required to release information to the public if so requested unless they could qualify for the limited exclusions under FOIA for specific types of information on the basis, for example, of confidentiality. The case is now on appeal.

105. See, e.g., National Governors' Association, *The Report of the Committee on Health Information for Policy Development* (1978). The Committee identified two basic categories of health information systems: "[i]ndividual systems developed primarily for the purpose of monitoring compliance with governmental programs," and "[d]ata systems developed, irrespective of compliance issues, for long-term planning and decisionmaking. Some of the major problems concerning health data systems seem to arise from the fact that the two systems are rarely integrated." *Id.* at 3. The report noted that great quantities of data are being collected at a substantial expense (between \$60 and \$80 million annually for HEW alone) and that "all too often these data are not translated into information [usable for program purposes] and not passed on to governmental or private decisionmakers in a timely fashion." *Id.* at 4. The Committee recommends a national health information system with ready access by both public and private users, and makes specific proposals regarding the components of the system, the flow of data, and the accuracy, accessibility and timeliness of data.

106. B. ABEL-SMITH, *VALUE FOR MONEY IN HEALTH SERVICES* 173 (1976).

munities that, at first appearance, might seem to have appropriate occupancy rates and lengths of stay in their facilities. Moreover, population-based reviews are also indispensable in identifying real public health problems.¹⁰⁷

E. CON Lacks Quality Control Mechanisms

At the present time, compliance with CON requirements, including submitting a project for review and complying with representations made on the application forms after the CON has been awarded, is neither monitored nor enforced. Perhaps for the great majority of providers this is unnecessary; voluntary compliance by a majority with the chief provisions of a regulatory scheme is always a precondition to the success of a regulatory program. But there are undoubtedly some providers who would not feel compelled to comply with requirements they find burdensome and useless. Furthermore, should CON reviews become more stringent, with chances for success consequently becoming less certain and the cost for preparing and presenting a CON application increasing, total reliance on an honor system may become a somewhat naive way to assure compliance with the terms of a review process that involves such vast sums.¹⁰⁸ The tight-lipped provider community, behaving much like the proverbial physicians in the operating room with their "conspiracy of silence," will rarely inform on one another. At the present time, provider gossip is the sole source of information to the CON agency about "end runs," since there is no audit of providers that would detect such evasive efforts, even under the cost determinations of Medicare, Medicaid or private insurers. Thus, there is no way to estimate the extent of this problem.

If a CON application is submitted and rejected, assuring compliance with the negative decision is also a matter of some concern. It is, however, the one aspect of this area that has received attention. HEW is now requiring states, as a precondition for full SHPDA designation

107. For instance, when a community is identified with a utilization rate for chest-related ailments markedly higher than for other communities with similar demographic characteristics, an investigation would examine the reasons for the disparity, including the possibility that the higher utilizing community suffers from an infectious, hereditary or environmentally related disease. See Wennberg & Gittelsohn, *supra* note 23. See also J. ROBBINS, *THE USES OF POPULATION-BASED DATA FOR RATE SETTING* (1976).

108. If the CON review process were administered in every state pursuant to federal requirements, it would have reviewed projects during 1978 totalling \$6.8 billion. *Hospital Cost Containment Act of 1977: Hearings on S. 1391 Before the Subcomm. on Health and Scientific Research of the Senate Comm. on Human Resources*, 95th Cong., 1st Sess. 839, 891 (1977) (statement of Alice M. Rivlin, Director, Congressional Budget Office) [hereinafter cited as *1977 Hearings*].

under P.L. 93-641, to possess adequate sanctions to enforce negative CON decisions,¹⁰⁹ and third-party payors, most notably several Blue Cross plans,¹¹⁰ have assisted CON reviewers in enforcing their decisions.

Once a CON has been granted, there is little continued monitoring to see if the applicant has complied with the terms of the CON project application. Frequently, the basis for a decision granting or denying a CON can be found in the specific assurances made in the application—for example, that the equipment will be purchased at a given price, that the charge for the service will be lower than that prevailing in the community, or that outreach efforts will be made to medically underserved areas. At present, however, little is done to ensure that these conditions are ultimately met. Even reports of cost overruns, for which many CON statutes require a subsequent approval, are now submitted chiefly on a voluntary basis and, at least in Colorado, are submitted more frequently by the smaller, rural facilities, which are not the primary target of the CON cost-containment, than by the large urban facilities with advanced accounting systems.

IV. PROPOSALS FOR REFORM

CON programs must be overhauled if they are to attain the stated purpose of helping to make the American health care system more effective, efficient and equitable. Experience indicates that, without extensive changes, the successes of the CON program will be few and far between and will be largely attributable to circumstances in which there is a dedicated agency, a substantial data base, an established tradition of intervention in the health delivery system, and a politically supportive environment—a cluster of factors neither present generally in the nation at this time nor likely to occur in the foreseeable future.¹¹¹

109. 42 C.F.R. § 123.405 (1977).

110. Blue Cross plans in Kansas City and Cincinnati have been especially active in this assistance. Over 20 plans have provisions in their reimbursement contracts with participating hospitals stating that the plan will not cover the costs of a project that has failed to receive planning agency approval. For a more detailed description of the aggressive steps taken by Blue Cross of Kansas City to reduce a controversial proposal from 120 new acute care beds to 40 in an area where there already was a documented excess of beds, see BLUE CROSS-BLUE SHIELD ASSOCIATIONS, *THE BLUE CROSS AND BLUE SHIELD CONSUMERS EXCHANGE* (1978). For an evaluation suggesting that Blue Cross plans may increasingly act in pro-consumer fashion in the future, see Schonbrun, *The Future of Blue Cross*, 2 J. HEALTH POL., POL'Y & L. 319 (1977).

111. Singled out for special attention have been such areas as Rochester, New York, where Kodak, Xerox and the University of Rochester have historically joined forces with elements of the consumer and provider community. Detroit (with the "big three" auto makers, the United Auto Workers, the University of Michigan and a traditionally progressive state government), Cincinnati

Consequently, what is needed are solutions tailored to the more typical circumstances that now confront most CON agencies. The strategies must seek to impose efficiency, economy, quality control and accountability on the CON system, and, whenever possible, they should be self-enforcing. Existing competitive pressures among providers should be relied upon whenever appropriate. Approaches designed to raise the public consciousness about costs should be sought. At the same time, proposed solutions should aim to provide the CON programs with sufficient political support and with appropriate incentives to carry out their responsibilities with vigor even in the face of advancing technology, the continuing political power of those supporting the status quo, the present lack of data, and the questionable quality of existing health service plans and review criteria.

With these objectives in mind, the remainder of this article will outline several proposals for reforming the CON system. First, a series of general reforms will be discussed, and then the following specific proposals will be examined in greater detail: (1) imposing on states an annual lid on new health-related capital expenditures; (2) requiring that a project first be cited in the facility's long-range plan before it can be considered for a CON; (3) providing for partial and conditional approvals; (4) applying the doctrine of *res judicata* to projects that are similar to proposals already rejected and the doctrine of the "substantial evidence" rule to CON appeals; and (5) imposing time-limited and/or site-limited moratoria on projects based on new medical technologies.

A. Streamlining the Process: General Suggestions for Reform

As in other license and permit procedures, the burden of proof in the CON process should be on the applicant. Yet, many current state statutes are vague or ambiguous on this point. In practice, it is frequently the CON decisionmaker who carries the true burden of showing that a proposed project should be rejected because it will not meet a community need as expressed by existing plans and criteria. The provisions of P.L. 93-641 help address this ambiguity, at least for new hospi-

(with an especially progressive Blue Cross plan, Proctor & Gamble and progressive city leadership), and Phoenix (with Motorola and a well-respected, long-tenured HSA director) have also been named. They are the exceptions that prove the rule, for there are few structural similarities among these cities, much less anything that could be readily transferred to other parts of the country.

tal in-patient services,¹¹² by requiring that the CON decisionmaker affirmatively make a series of findings regarding need. Despite this improvement, the issue of burden of proof is still unclear and should be resolved. Rigor in applying an appropriate burden of proof will not only aid the efforts of the CON review agency, but also may change the applicant's behavior and subsequently its willingness to consider, when necessary, appropriate alterations to an already submitted application.

Information is an indispensable tool for adequate planning and regulation. Data that is both demographic-based and facility-specific (especially regarding quality of care costs) can be obtained through an improved data collection and dissemination effort. Much data is already available and in the possession of such quasi-public agencies as PSROs and the Joint Commission on Accreditation of Hospitals (JCAH), as well as state and federal Medicaid and Medicare agencies, but has not been aggregated or released to health planning or CON programs.¹¹³

A code of ethics must be established for CON reviewers, both to guide their efforts and to shield them from inappropriate political pressures.

In the interest of improving the system's accountability, reducing the costs (both economic and social) of compliance, and making its decisions more consistent and more rigorous, there should be a unified CON administrative review process and a single definitive CON decisionmaker. Under such a system, responsibility for breakdowns could be clearly assigned, and interested parties, such as concerned consumer groups and other providers, could concentrate their efforts on a single proceeding. Applicants could focus their efforts toward satisfying the concerns of only one decisionmaker, thus eliminating the "whipsaw" effects that may now occur in the present system—either of the applicant by the HSA and the state agency (for example, the reviewing agencies making incompatible demands of the applicant) or of the reviewing agencies by the applicant (for example, the proponent playing off one agency against the other).

Furthermore, this unified CON review process should be a state operated system.¹¹⁴ Despite the role played by the federal government

112. 42 C.F.R. § 123.410 (1977).

113. See notes 104 & 105 *supra*.

114. For a review of the increasing federal support for the concept of a larger voice for states in health policy formation and administration, see Igglehart, *Carving Out a Role for States in Con-*

in establishing CON programs, they are basically state administered. Legal assistance, increasingly necessary as the CON and health planning system grows more litigious, is provided through each state attorney general's office.¹¹⁵ The governor, with power over the tenure of ranking agency officials, and the state legislature, with control over funding appropriations for the program, can effectively monitor and, when necessary, correct abuses in the operations of the CON programs. Coordination with other related regulatory reviews, including facility licensure and hospital rate review (in those states where it exists), can only be effected at the state level.¹¹⁶

Giving the HSAs or other quasi-public bodies the power to make final CON decisions would create several problems. Because HSAs are generally sub-state entities, problems regarding intrastate consistency would be likely—a potentially troublesome occurrence, particularly since states continue to be the most frequently used political boundaries for health decisionmaking and data collection.¹¹⁷ Most HSAs operate without specific state enabling legislation, and many continue to suffer from inadequate consumer involvement and, consequently, insufficient political accountability.¹¹⁸ In many states, such as New York, their relationship to other ongoing state regulatory review programs has reportedly been one of competition and/or avoidance. The HSA's

trolling Hospital Costs, 10 NAT'L J. 1045 (1978). See also Somers & Somers, *supra* note 24, at 154-55 for support for the idea that the state should play the dominant role in CON.

115. The comments of an attorney who represents several California HSAs are illustrative:

From the HSAs' perspective, perhaps the key issue is one of too many lawyers or, to put the matter more accurately, the issue is the gross disparity between the vast amount of legal resources available, on the one hand, to the health industry and the relatively small amount of legal time available to the HSAs, on the other. . . . As part of the [hospital] industry strategy, any planning activity perceived as an undesired constraint on expansion of the industry is translated into an issue to be resolved in a legal forum such as a court or the legislature. Virtually all effective acts on the part of health planners are so perceived. In short, the health planning process has been so legalized that agencies without legal resources have little, if any, role in the final decision-making process. . . . [H]ealth planners, because they have lost almost all their legal battles, have been intimidated in their pursuit of planning options, and the HSAs in this state at least have become growingly isolated from any significant role in CON determinations.

S. Price, *Health Planning and the Law* 7-9 (speech delivered at the National Health Lawyers' Association Conference, October 27, 1978).

116. See generally MILLER & BRYNE, INC. & JPB ASSOCIATES, INC., FINAL REPORT: EVALUATION OF THE IMPACT OF PHS PROGRAMS ON STATE HEALTH GOALS AND ACTIVITIES (Health Resources Administration, Washington, D.C. 1977); Altman, *The Politics of Health Care Regulation: The Case of the National Health Planning and Resources Development Act*, 2 J. HEALTH POL., POL'Y & L. 560 (1978).

117. National Governors' Conference Center for Policy Research Analysis, *Making the National Health Planning Law Work: The State Perspective* (1977).

118. See, e.g., *Texas Acorn v. Texas Area 5 Health Systems Agency, Inc.*, 559 F.2d 1019 (5th Cir. 1977).

"voluntary" approach to problem solving based on a consensus model of decisionmaking and its proximity to "grassroots" concerns of access rather than systemic cost-containment make rigorous CON decision-making exceedingly difficult.¹¹⁹ At present there are no comprehensive comparisons of the CON performance by HSAs vis-à-vis that of state agencies,¹²⁰ but in Colorado, at least, CON reviews performed by HSAs have tended to be less rigorous and less sensitive to cost-containment concerns than those conducted by the state.¹²¹

The HSAs, however, could play a productive role under a unified system that would be very appropriate for these regional planning bodies. Specifically, the HSAs could provide more technical assistance to applicants, stimulate new CON applications to address current community needs, and serve as an "honest broker" between the applicant and the state CON review agency. The HSAs could also monitor the conformity of CON decisions with the various plans being generated under the provisions of P.L. 93-641—plans that HSAs play a dominant role in formulating. Under the present system, with its redundancy of functions, neither the SHPDA nor the HSA has had the staff or the time necessary to perform any of these important tasks adequately.

Finally, HSAs could serve as a "backstop" for the CON system. In instances such as that in Ohio when the state CON review agency fails to carry out its duties in a responsible way,¹²² the HSAs within a state could—singly or collectively—be authorized by HEW to take over the role as the CON decisionmaker for the state.

Plans and criteria should be formally promulgated as regulations under the state's APA before they are relied upon by the CON decisionmaker. A federal court in Nebraska recently reversed a negative decision rendered by the state CON decisionmaker because it failed to

119. See generally A. Wildavsky, *Can Health Be Planned?* (1976 Davis Lecture, University of Chicago Graduate School of Business).

120. The survey now being conducted by the American Health Planning Association may provide the base data for such a comparison. See note 37 *supra*.

121. See, e.g., Colorado Dep't of Health, *Annual Report of the Health Facilities Advisory Council* (1978). See also Altman, *supra* note 116, at 572-73 (citing seven recent reversals in a six month period of HSA decisions by the state CON decisionmaker in Massachusetts).

122. See H. Foley, *Report of the Health Resources Administrator* (HEW, Washington, D.C. 1978). The report notes that the Administrator of HRA threatened the state CON agency, the Ohio Department of Health, with loss of its SHPDA designation and potentially other HEW funding if it did not improve its CON performance. The Ohio agency had overturned, without explanation, two negative HSA recommendations on multi-million dollar hospital expansion projects in Cincinnati and Dayton.

have its criteria properly adopted.¹²³ The court made this ruling even though the state agency was operating only under the authority of the 1122 program,¹²⁴ whereby it rendered not a final decision but only a recommendation to HEW, and even though the 1122 statute and regulations themselves contain criteria of much detail and specificity, which would tend to obviate the need for further rulemaking. In New Jersey, where the courts have granted state authorities considerable latitude in conducting the CON program, rulemaking has also been widely regarded as a basic precondition for a legally sound CON system.¹²⁵

Finally, proponents of a strong CON system will find that they can bolster their authority over the health system through rulemaking efforts. Courts are more inclined to defer to the expertise of administrative agencies and to allow those agencies broader discretion when they engage in actions that have a general effect and are only prospective in nature (rulemaking) than when they engage in actions that affect the rights of specific parties and are retrospective in nature (adjudications).¹²⁶

B. Living Within a Budget: Setting an Annual Lid on Capital Expenditures

During the past two years increasing attention has been paid to the concept of capping the nation's health expenditures.¹²⁷ In Rhode Is-

123. *Nebraska Methodist Hosp. v. Casari*, [1978 Transfer Binder] MEDICARE & MEDICAID GUIDE (CCH) ¶ 29,205 (D. Neb. Aug. 18, 1978).

124. *Id.*

125. *See generally* *Cooper River Convalescent Center, Inc. v. Dougherty*, 133 N.J. Super. 226, 336 A.2d 35 (1975) (upholding legality of 18-month moratorium on construction of intermediate care facilities promulgated as regulation by regular body of state government, the Health Care Administration Board).

126. *See generally* *Northwest Hosp. v. Illinois Health Facilities Planning Bd.*, 59 Ill. App. 3d 221, 375 N.E.2d 1327 (1978). The court observed that the standard for reviewing the determinations of an administrative agency varies with the nature of the action taken:

"When an administrative agency exercises its rulemaking powers, it is performing a quasi-legislative (as opposed to a quasi-judicial) function. This fundamental principle explains the discrepancy in the standards of judicial review of each type of proceeding; that is, when dealing with an adjudicatory proceeding, a reviewing court may only set aside the agency decision if it is clearly against the manifest weight of the evidence. When reviewing administrative rules and regulations, on the other hand, a court may not invalidate the regulation unless it is clearly arbitrary, unreasonable or capricious, because administrative agencies are inherently more qualified to decide technical problems and the mechanics of dealing with them. Because the courts lack the expertise possessed by administrative agencies, they should hesitate to find a regulation unreasonable."

Id. at 226-27, 375 N.E.2d at 1331-32 (quoting *Shell Oil Co. v. Pollution Control Bd.*, 37 Ill. App. 3d 264, 270-71, 346 N.E.2d 212, 218 (1976)).

127. *See, e.g.*, 125 CONG. REC. S2216 (daily ed. March 7, 1979) (remarks of Sen. Javits).

land a consortium of public and private agencies sought to impose a "maxicap" on total expenditures in all hospitals of the state.¹²⁸ A similar voluntary effort is now underway in Rochester, New York.¹²⁹ In the Hospital Cost Containment Bill of 1978, President Carter proposed that limits on expenditures be imposed in two distinct areas of rising costs: capital expenditures were to be limited to \$2.5 billion annually, with allocations assigned to each state based on population, while increases in a facility's operating costs were to be kept, subject to tightly drawn exceptions, within a 9% cap.¹³⁰ In 1979 a new federal cost containment bill was introduced, designed to set the lid on capital expenditures at \$3 billion and on operating expenses at 9.7 percent.¹³¹ New York has been contemplating a lid on new capital expenditures alone, believing it too difficult, both technically and politically, to impose a cap on operating costs.¹³²

The implications for CON reviews of imposing a capital expenditure limit are significant. By establishing an overall budget for capital expenditures, several positive effects should result. First, the substantial capital expenditures and operating costs that accompany new projects would be significantly curtailed. The \$2.5 billion lid originally proposed by President Carter was estimated to be approximately fifty percent of the total spent the previous year on capital expenditures.¹³³ Additional savings in operating costs would also be substantial inasmuch as it has been estimated that the annual operating costs that accompany a new capital expenditure range between twenty and one hundred percent of the total cost of the capital expenditure itself.¹³⁴

Second, by setting the lid at a specific figure that is high enough to be responsive to demonstrated needs yet low enough to result in cost savings, the concept of "relative need" can be introduced into the CON

128. See generally Zimmerman, Buechner & Thornberry, *Prospective Reimbursement in Rhode Island: Additional Perspectives*, 14 INQUIRY 3 (1977).

129. Sorenson & Saward, *An Alternate Approach to Hospital Cost Control: The Rochester Project*, 93 PUB. HEALTH REP. 311 (1978).

130. Several bills were introduced during the 1978 congressional session. The most prominent were S. 1391, introduced by Sen. Edward Kennedy (D. Mass.), and H.R. 9717 and H.R. 5285, introduced by Rep. Paul Rogers (D. Florida). See generally HEALTH CARE FINANCING ADMINISTRATION, DEP'T OF HEALTH, EDUCATION AND WELFARE, HOSPITAL COST CONTAINMENT: A SUMMARY OF LEGISLATION PENDING BEFORE THE SENATE OF THE UNITED STATES (1978).

131. 125 CONG. REC. S2207 (daily ed. March 7, 1979).

132. See generally NEW YORK STATE OFFICE OF HEALTH SYSTEMS MANAGEMENT & NEW YORK STATE HEALTH PLANNING COMMISSION, BRIEFING BOOK: THE CAPITAL EXPENDITURE LIMIT PROGRAM (1978) [hereinafter cited as NEW YORK STATE BRIEFING BOOK].

133. See 1977 Hearings, *supra* note 108, at 892.

134. See Somers & Somers, *supra* note 24, at 153-54.

review system.¹³⁵ This concept brings an element of discipline into the health care system by forcing CON reviewers to recognize that while virtually any project may be found to benefit some people,¹³⁶ some projects will prove more beneficial to the population at large, and because of the growing constraint on resources should be given priority. For example, a project that provides primary care services to a medically underserved population such as migrant workers or inner-city families should be granted a higher priority¹³⁷ than a tertiary care project involving a new piece of medical equipment of untested efficiency, effectiveness or safety capable of serving relatively few patients and yielding no meaningful research findings.¹³⁸

Under this system, the inclination of CON reviewers to say yes to a project of limited or unknown value would decrease,¹³⁹ for several reasons. With a limited budget, approving a marginal project may force CON reviewers to disapprove a more deserving project later in the year; consequently, proponents of projects (especially those submitted early in the year) will have to meet their burden of proof. Providers themselves may find it necessary to testify against projects of other providers to preserve funds in the system for their own projects. This would help to generate a favorable political environment for CON reviewers that would be more conducive to saying no than the present one marked by its "logrolling" efforts.¹⁴⁰ This environment might also help produce useful critiques of projects that often can be prepared only by another facility. What the market has failed to produce and what the antitrust laws have, to date, failed to remedy may instead be fostered by an annual cap on CON expenditures.

Furthermore, under such competitive circumstances, a full reli-

135. See NEW YORK STATE BRIEFING BOOK, *supra* note 132, at 5-11.

136. In some instances, as with convenience items for physicians, the benefit may fall primarily on the providers themselves.

137. "Over a third of America's children, especially those who are poor or are members of minority groups, are not immunized against childhood diseases; thus, epidemics of diphtheria and measles still occur with unpleasant frequency." Silver, *Health Services for Children*, YALE ALUMNI MAGAZINE & J., February 1979, at 14.

138. See generally A. COCHRANE, *supra* note 98. Cochrane notes the need to conduct rigorous effectiveness trials on new methodologies for the delivery of care before introduction to the general market. The treatment of research oriented projects received little attention in the congressional hearings held prior to the passage of Pub. L. No. 93-641.

139. See, e.g., H. Cohen, *New Principles of Reimbursement for Capital Costs, Geared to HSA and SHPDA Plans*, in LINKING HEALTH PLANNING AND REGULATION TO INCREASE COST EFFECTIVENESS, *supra* note 54, at 8-12; NEW YORK STATE BRIEFING BOOK, *supra* note 132, at 11.

140. See generally Nelson & Winter, *In Search of a Useful Theory of Innovation*, 6 RESEARCH POL'Y 36 (1977).

ance on health plans for CON decisionmaking would be less necessary because a more complete record would be developed based on the informed comments provided by rival institutions.¹⁴¹ Substantive comments from competing providers would supplement the established plans and criteria if they were comprehensive and of good quality or help supplant them if they were overly narrow, biased or of poor quality. This feedback would also be useful in examining the quality of prepared plans and criteria indicating areas requiring revision or wholesale change.

If a federal cost containment bill were enacted, an annual lid of \$2.5 or \$3 billion would be instituted for all proposed capital expenditures nationwide. Allocations of the total amount would be made on a state-by-state basis according to population. Further allocations could be made by state officials according to health service area or other sub-state geographical unit. State CON reviewers would presumably administer the capital expenditure lid. Such an arrangement might have considerable utility. The state officials, midway between the pressures of local communities and local providers on one hand and the federal government on the other, could make tough but still well-informed decisions. The state CON program could benefit from having to operate within a budgeting constraint, but its officials would not have to take the political heat for its existence or its level. Even if the CON program were to become an increasingly state-operated program as recommended above, cost-containment considerations would be accorded great weight, if for no other reason than the financial pressures that rising Medicaid and health insurance coverage costs for the large work force of state employees continue to place on state budgets and consequently on state taxes.¹⁴²

141. See, e.g., *Olathe Hosp. Foundation v. Extencicare, Inc.*, 217 Kan. 546, 539 P.2d 1 (1975). In *Olathe*, two nonprofit hospitals challenged a CON proposal by a for-profit hospital chain to establish a new 400 bed facility almost midway between them. Several recent cases in New Jersey, where batching of applications is an established practice, are also of interest. See, e.g., *National Nephrology Foundation v. Dougherty*, 138 N.J. Super. 470, 351 A.2d 392 (1976) (one CON awarded to establish an intermediate renal dialysis facility although three applications reviewed concurrently). See also *Saint Joseph's Hosp. v. Finley*, 153 N.J. Super. 214, 379 A.2d 467 (1977), cert. denied, 75 N.J. 595, 384 A.2d 825 (1978). In *Saint Joseph's*, a CON for a cardiac surgery program was denied on the ground that only two of nine facilities presently offering the service in the region met a minimum standard utilized by the CON decisionmaker. Although the cardiac surgery standard used had not been promulgated as a regulation, the court found that sufficient credible evidence existed in the record. *Id.* at 222, 379 A.2d at 470. The court's opinion is silent on the role played by the nine other facilities, but it is clear that information on the utilization of the other hospitals' services—whether volunteered by the other facilities or solicited by the reviewers—played a critical role in establishing the necessary credible evidence.

142. In Massachusetts, for example, a \$90 million increase in Medicaid expenditures between

Several states may not wait for federal action. Officials in New York and Maryland have capital expenditure programs under active consideration.¹⁴³ Like the pending federal legislation, the state programs would establish relative need as the context for all CON decisions and would consequently affect the behavior of CON reviewers, providers and other interested parties. A lid thus enacted at the state level might have greater perceived legitimacy to the general public and the provider community than one passed in Washington. Greater sensitivity to unique local conditions, such as the rapid population growth in parts of the West and South requiring new construction projects or the aging physical plants of established medical centers in the urban Northeast requiring extensive renovation work to meet building and fire code requirements, might also make the lid established for a state or sub-state region more appropriate than one based strictly on present state population figures. Nonetheless, a federal overview of state established capital expenditure limits might be necessary and appropriate if only to assure that the total sum of the state lids did not exceed an acceptable national level.

Determining the actual level of the lid will necessarily involve an element of arbitrariness and negotiation, not only because the human need for health care and its desired and presumed end-product—good health—is difficult to value,¹⁴⁴ but also because the tools to evaluate the impact of capital expenditures on total actual health expenditures are currently very imprecise. If the nation decided that it wanted to place a total limit on how much it would expend in the health care sector¹⁴⁵ (as it presently does, for example, for national defense), and it agreed to thirteen percent of the gross national product (for example, ten percent for direct health services, one percent for research,¹⁴⁶ one percent for

fiscal years 1977 and 1978, from \$630 million to \$720 million, represented more than one-half of the \$160 million increase in the state budget during that period, with 73% of these expenditures attributable to hospital and nursing homes, the target of CON and other P.L. 93-641 functions. Altman, *supra* note 116, at 569-70.

143. See, e.g., H. Cohen, *supra* note 139; NEW YORK STATE BRIEFING BOOK, *supra* note 132, at 7-18.

144. See generally Knowles, *The Responsibility of the Individual*, 106 DAEDALUS 57 (Winter 1977). See also M. LALONDE, A NEW PERSPECTIVE ON THE HEALTH OF CANADIANS (1974).

145. This approach assumes a constraint on both capital expenditures and operating revenues.

146. One of the corollary benefits of establishing a lid on capital expenditures and consequently on direct health services would be to help preserve adequate funding for research and teaching efforts that now face serious cutbacks as a result of the burgeoning Medicare and Medicaid budgets and the present drive to establish a balanced federal budget. See, for example, the recent statement by Sen. Edward Kennedy:

Rising health care costs have also hampered the ability of Federal and State govern-

teaching new health professionals and one percent for public health education), no one could calculate with any certainty how much in capital expenditures should be allowed in a specific year to reach the thirteen percent level. This would be true because of the varying and unpredictable level of operating costs that are associated with capital expenditure projects.

The arbitrariness necessarily involved in setting the level of the lid has just recently been illustrated by the federal government. In 1978 the level of the federal lid proposed was \$2.5 billion, a figure estimated as being one-half of the nation's capital expenditures for health facilities and services during the preceding year. As stated earlier, for 1979 the Carter Administration's latest proposal is for a lid of \$3 billion—an increase of nearly seventeen percent (approximately twice the rate of the Consumer Price Index during the same period). The amount of the increase has undoubtedly been prompted as much by political considerations (if \$2.5 billion failed to get congressional approval, then perhaps \$3 billion will succeed) as by any recalculation of the nation's health needs.

Officials in New York have been considering a range of approaches from using, on the low side, the average amount approved annually during the last three years under the state's CON program (estimated at \$250 million per year) to, on the high side, the annualized cost of replacing needed facilities (approximately \$400-500 million) with ten percent of the statewide cap held back by the state for discretionary purposes.¹⁴⁷

While some experimentation on this subject may be worthwhile, implementation of such an approach should not be delayed solely because there is no unanimity among policy experts on the ideal level of an imposed lid. As in setting any budget, some arbitrariness is unavoidable. Once an initial level for the lid has been set, marginal altera-

ments to meet other pressing social problems. For example, between 1966 and 1978, the HEW health budget increased from \$3 to \$44.5 billion. Of this increase, \$37.3 billion has gone to pay for benefits under medicare and medicaid, with only \$4.2 billion left over for expansion of other governmental health activities beyond their 1966 level. . . .

Tragically, we are pouring so much money into hospitals right now for extra beds, for unneeded tests, for unnecessary surgery that we have not had money to spend on basic preventive health care. It is more humane, and it would be a lot less expensive, to prevent illness than to put someone into a hospital to cure them.

125 CONG. REC. S2214 (daily ed. March 7, 1979).

147. A provision to exceed the cap if the state commissioner of health finds that the lives and safety of patients would otherwise be endangered is also included in the New York plan. NEW YORK STATE BRIEFING BOOK, *supra* note 132, at 14. The New York plan identifies large multi-year projects as potential beneficiaries of the 10% discretionary fund. *Id.* at 10-11.

tions can be legislated and an indexing system could be used to peg future increases to, for example, rises in the Consumer Price Index or another appropriate index.

Less useful, but also possible, would be a flexible, non-binding guideline on capital expenditures. These guidelines might be adopted by CON programs without further legislative authorization. A self-imposed lid could serve a useful purpose as a continuing reminder to the CON reviewers that funds for health services are not unlimited and that relative need should be considered. Whether the CON reviewers would have the discipline to utilize consistently such a guideline as a decisionmaking tool, and whether providers would feel sufficiently constrained by the existence of the guideline to compete effectively against one another is difficult to predict.

While the constitutionality of CON programs has been generally upheld, a statutorily enacted cap on capital expenditures would undoubtedly be challenged and, due to the across-the-board impact on all providers, would present the courts with a more difficult question.¹⁴⁸

148. The constitutionality of regulations pertaining to costs as well as quality in the private health care sector has been repeatedly upheld by state and federal courts during the past decade, most recently by the United States Supreme Court in North Carolina *ex rel. Morrow v. Califano*, 435 U.S. 962 (1978), *aff'g mem.*, 445 F. Supp. 532 (E.D.N.C. 1977). The Court affirmed without opinion a lower court decision that the certificate of need provisions of P.L. 93-641, which require that each state enact a CON law in conformity with federal requirements or suffer the loss of grant-in-aid funds for specific federal health programs, did not violate the first, fifth or ninth amendments to the United States Constitution by seeking to "convert private facilities into public facilities subject to federal regulation and 'interfer[ing] with the physician-patient relationship by rationing health resources for reasons unrelated to the promotion of high quality care.'" 445 F. Supp. 532, 533 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978) (emphasis added).

In its opinion, the district court, noting that there were no "real issues of contested fact" and that "the dispositive issues are legal," *id.* at 533-34, observed that if CON covered only "public construction"

the public interest in avoiding unnecessary increases in health care by reason of the addition of unneeded additional facilities could be thwarted by private construction. For this reason, every court which has considered the constitutional validity of state certificate of need laws has found . . . the inclusion of private construction within the law's coverage valid and reasonable, save in the North Carolina case [*Aston Park*] already cited.

Id. at 536. The court thus found it necessary to an effective CON program to cover private as well as public health facilities if the "public interest" of cost-containment was to be addressed in a meaningful way. It barely mentioned that private investment decisions in the health industry about development and expansion would be curtailed by governmental decisionmaking. Further, the court did not rely on quality of care considerations to bolster its ruling, even though quality of care has long been an area in which the state's power to regulate the private health industry has been uncontested, and it is now commonly understood that avoiding duplicative health services often will have a significant and beneficial impact on quality as well as costs. Finally, the court found that there was no basis for the claim that CON constituted an unlawful invasion of the patient-doctor relationship. *Id.* For other cases supporting the constitutionality of CON laws, see *Simon v. Cameron*, 337 F. Supp. 1380 (C.D. Cal. 1970); *Merry Heart Nursing & Convalescent*

Nonetheless, were the Congress or a state legislature to find the establishment of a lid on capital expenditures to be necessary to contain costs, and were the lid reasonable and based on factors such as those being weighed in New York, then the reasoning relied on in recent judicial decisions upholding CON programs in general should still be sufficient to uphold the validity of a properly enacted capital lid.¹⁴⁹

Home v. Dougherty, 131 N.J. Super. 412, 330 A.2d 370 (1974); Attoma v. Dep't of Social Welfare, 26 App. Div. 12, 270 N.Y.S.2d 167 (1966). But see In re Certificate of Need for Aston Park Hosp., 282 N.C. 542, 193 S.E.2d 729 (1973).

149. An interesting problem might be created if Congress enacted a national lid and a state, either before the federal enactment (as perhaps in New York or Maryland) or after it (if, for example, a state legislature in a western state believed that the federal formula for allocating expenditures failed to give due regard to its projected population growth), passed a capital expenditure lid whose provisions were inconsistent with the terms of the federal act. An uncritical reading of the recent decision in *Park East Corp. v. Califano*, 435 F. Supp. 46 (S.D.N.Y. 1977), which involved a small private hospital in New York City, would suggest that, despite the traditional hegemony of the states in the area of health care regulation, federal preemption of the state lid might now result. The hospital in *Park East* challenged a delicensure action instituted against it by the state health department on the grounds that it was actually a decertification action and that the specific procedures for such actions mandated under P.L. 93-641 had not been complied with. The state licensing agency, which was also the SHPDA, asserted that not only were its actions based on relevant licensure factors—specific violations of state quality of care standards—but that even if it were seeking to decertify the hospital for cost-containment reasons this action was authorized under the state's own decertification statute. The court ruled in favor of the hospital, holding that P.L. 93-641 had preempted the state's decertification process and, for all intents and purposes, its delicensure powers as well, because their efforts had been "motivated by a desire to eliminate excess hospital beds in New York State in contravention of the Act." *Id.* at 50.

The *Park East* opinion is troubling and, I believe, wrong for several reasons. First, nowhere in the legislative history of P.L. 93-641 is there any indication that Congress intended a federal preemption of all state initiatives in the field of health planning (§ 1526 of the Act even expressly authorizes special grants for states to conduct rate review experiments). Second, any hospital under threat of closure for reasons relating to poor quality care could invoke *Park East* if it happened to be located in an area deemed to have a surplus of beds (as most areas of the country are now believed to have). It could seek injunctive relief to prevent any state delicensure action for as long as the HSA takes to render a decision on the "appropriateness" of the facility in question. This could take a minimum of several years. Thus, the state's authority to regulate hospitals and ensure their compliance with state health and hospital codes could be seriously undermined, despite language in *Park East*, *id.* at 55, specifically stating that its decision would not affect the state's "inherent police powers" to ensure quality of care in health facilities.

The present status of *Park East* is unclear. It has been widely criticized, but has not been appealed by the state. While it appears to be a poorly decided case, if it does signal a new willingness on the part of federal courts to give such overriding deference to federal enactments, then the long-time domination of the states in the field of health care that began to erode with the passage of Medicare and Medicaid may be crumbling further.

Should the *Park East* ruling prove persuasive to other federal courts, the provisions of the federal lid would, whenever the state law was inconsistent or silent, take priority. If the case is given a more narrow reading and limited to situations in which the state officials may not have had clean hands, then a different result may be reached. The states might argue that the ninth amendment grants the states sovereign authority in this area. See, e.g., the short shrift given to the ninth amendment argument in *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978). But see Wing & Sifton, *Constitutional Authority for Extending Federal Control Over the Delivery of Health Care*, this Symposium, at text accompanying notes 72-112.

C. The Plan's the Thing: Relating an Applicant's Long Range Plan to Its CON Projects

Requiring that a facility include any proposed CON project, except for emergencies, in an institutional plan operational for at least one year in advance has significant merit.¹⁵⁰ By providing notice beyond what is now offered in some states by the letter of intent,¹⁵¹ it alerts the CON reviewers and planners to the possible need for developing or updating review criteria or plan sections related to the proposed project.

If it is a public document,¹⁵² the institutional plan also alerts other providers to the facility's intentions, opening the way for negotiations among the community's providers to offer jointly the service in ques-

To the extent that the sanctions levied against those hospitals that violate the federal law are limited to Medicare (a totally federal program) and Medicaid (a mixed state-federal program under which the federal government assumes a majority of the program's costs), then it is likely, following the reasoning of *North Carolina ex rel. Morrow v. Califano*, that the federal law would supersede the state's. The court in *Morrow* upheld the right of the federal government to attach conditions to health grants made to the states under federal health programs. This reasoning would certainly apply to the federal Medicaid funds. As for Medicare, this program is totally under federal control—both financially and administratively—and consequently the Congress can apparently make whatever policy decisions regarding the program that it deems proper.

150. See generally Massachusetts Department of Health, Massachusetts Hospital One and Five Year Plan FY 1978-1982, Vol. I, Background and Purpose, (1977). Massachusetts requires both a one-year and a five-year plan, although only the one-year plan is binding for CON reviews. Here is a description of the two documents:

The one year plan is a formal planning document setting forth the actions which the hospital plans to take in the forthcoming fiscal year in furtherance of the five year plan being submitted at the same time. This plan shall, at a minimum, identify all projects planned for the forthcoming fiscal year which will require a determination of need; present data supporting the need for each planned project; estimate the impact of each planned project upon current utilization patterns; state the relationship of each planned project to the hospital's five year plan; report on the progress and impact to date of projects undertaken pursuant to determinations of need granted within the last five years (or earlier in the case of any projects which have not yet been completed and in operation for two years); and include the capital and operating budget for the hospital during the forthcoming fiscal year.

The five year plan shall be a formal planning document projecting the purpose and goals of the hospital for at least the next five years in light of the major health care requirements of the population within the hospital's service area. The plan shall, at a minimum, describe the hospital's planning process; give a demographic profile of the hospital's service area, and identify major health care requirements of the population; describe the physical plant and the services of the hospital with patient origin and utilization data by major services; estimate the impact of major external forces upon the hospital's services; identify alternative courses of action, with preferences or selections stated and reasons given for each; identify preferred or selected courses of action which might require a determination of need; and describe the procedure to be followed in assessing the likely impact of the preferred or selected courses of action.

Id. at 1. See also Medeiros, *supra* note 54.

151. Regarding the 1122 program, see 42 C.F.R. § 100.106(a)(1) (1978).

152. Under the provisions of 42 U.S.C. § 300m-1(b)(6) (1976), public access to the files of the SHPDA is guaranteed.

tion or to arrange for a trade-off of services among the facilities. This would be more likely if a capital expenditure limit were also imposed. Other facilities can also better prepare critiques of the project with sufficient advance time, or else schedule their own competing applications for the service in question and thus open up the prospects for "batching." Batching offers the possibility of comparing the relative merits of several comparable projects all seeking to address the same community need when the community's need can be adequately filled by any one of the proposed projects.¹⁵³ Here as elsewhere, competitive forces can supplement the effectiveness of the CON regulatory scheme.

In addition, an institutional plan is likely to improve the internal planning capabilities of health facilities—long a neglected area even though other large and complex economic organizations in the nation have bolstered their planning capabilities.¹⁵⁴ Such planning efforts should also be useful in providing administrators and trustees with increased management control over the institution's future vis-à-vis the medical staff, the sector within the hospital that is the usual initiator of CON proposals.

Once emergency situations have been exempted, a legislative requirement that projects first be cited in plans on file with the CON reviewers should easily withstand constitutional challenge.¹⁵⁵ Absent an express grant of legislative authority, rulemaking efforts on this matter may even be sustainable as consistent with the general intent of CON to ensure the reasonable development of a state's health care system. Additional legal authority for such rulemaking efforts can be found in those state CON laws containing language dealing with re-

153. See, e.g., *National Nephrology Foundation v. Dougherty*, 138 N.J. Super. 470, 351 A.2d 392 (1976); *Saint Joseph's Hosp. v. Finley*, 153 N.J. Super. 214, 379 A.2d 467 (1977), *cert. denied*, 75 N.J. 595, 384 A.2d 825 (1978). The proposed New York regulations, § 710.11(a), Subchapter C, Chapter V, Title 10 (Health) of the Official Compilation of Codes, Rules and Regulations of the State of New York establish review periods for project types whereby specific projects may be considered only during a limited time in a year. For example, all hospital tertiary service projects may be heard only from January to April of each year. This constraint on scheduling obviously leads to a batching of like projects, allowing for a comparative analysis of their merits, including quality, accessibility and costs. See also *Bio-Medical Applications of Clearwater, Inc. v. Department of Health & Rehabilitative Services*, [1979] 3 MEDICARE & MEDICAID GUIDE (CCH) ¶ 29,559 (Fla. Dist. Ct. App. Feb. 23, 1979) (failure of CON agency to consolidate and conduct comparative hearing for two opposing bona fide, timely and mutually exclusive applications for the establishment of kidney dialysis facilities in the same area was material procedural error; case remanded).

154. See, e.g., *Massachusetts Department of Health*, *supra* note 150, at 2.

155. See the discussion of *North Carolina ex rel. Morrow v. Califano*, *supra* note 149.

view criteria that reference a project's conformity with the long-range plans of health care institutions.

D. Of Approvals—Partial and Conditional

It is not uncommon for CON applicants to present for review multifaceted projects that may entail both new equipment and construction, include several different service areas, or contain a mix of new services and building renovation projects. Frequently, these projects may be completed in stages extending over several years. Such proposals tend to carry a high price tag, and not uncommonly, they may include some components that are meritorious and others that are of dubious value. The common response by CON reviewers to such projects is to seek to identify as early in the process as possible those components that are of questionable utility and negotiate with the applicant to have these deleted.

The capability to negotiate reductions in project scope tends to vary with the nature of the proposal, the credibility of the CON reviewers, the project's importance to the applicant, and frequently, the likely outcome if the compromise is rejected. Under the present system, it is always the applicant who has the power to determine whether to compromise or to proceed with the original proposal. When negotiations fail, in whole or in part, the CON decisionmaker must then make the difficult decision whether the good points of the proposal sufficiently outweigh the bad to warrant the recommendation or granting of an approval. Politically, as well as technically, such decisions are exceedingly difficult, for saying no requires denying a proposal with some, if not many, significant merits.

To respond to these dilemmas, the Wisconsin legislature recently passed amendments to its CON law that authorize the state CON decisionmakers to render partial approvals.¹⁵⁶ The authority to approve some aspects of a project while rejecting others provides the CON reviewers with a significant tool, albeit one that may be double-edged. On the positive side, the reviewers need not wait passively for the applicant to decide whether or not to negotiate. Furthermore, under the prevailing system, once the applicant does agree to participate in negotiations, the burden tends to shift to the reviewers to make a comparable gesture by yielding on some of its demands for the project. Under a Wisconsin-type scheme, the applicant can neither expect nor seek, ex-

156. WIS. STAT. ANN. § 150.06(3) (West Cum. Supp. 1978).

pressly or implicitly, any concession in the stringency of the review for agreeing to negotiate. When the reviewers are empowered, with or without the consent of the applicant, to reduce the scope of a project, no such *quid pro quo* can be expected. Should a compromise prove impossible, the CON reviewers can still approve the meritorious components of the project without rejecting the entire proposal.

On the negative side, applicants may seek to overwhelm the CON system by "trimming out the Christmas tree"—filling CON proposals with large numbers of components—some needed, some not—to force the reviewers to search for, identify and approve necessary elements while rejecting less meritorious components. A large portion of the reviewers' limited time could thus be spent in unproductive work. Also, much of the present incentive to negotiate questionable aspects of CON proposals could be dissipated if providers perceive that the negotiation requirement has been replaced by a CON decisionmaking system that provides for partial approval. This was one concern voiced by Wisconsin state officials after they were given the new authority to grant partial approvals.¹⁵⁷ At this time it is impossible to assess the full impact of the new Wisconsin law.

Conditional approvals for CON are more commonplace, although they are frequently not recognized as such. Whenever a CON proposal is approved, the decision is based on representations found in the application—for example, that *X* new beds will be established, that the occupancy rate will be eighty-five percent, that residents of three contiguous counties will be served, or that a CAT scanner will be installed serving an average of *Y* patients per day at a cost of *Z* dollars per scan. Such representations are an integral part of every CON application and constitute a critical part of the record relied upon by the CON decisionmaker and appellate review bodies. This is especially true when competing applications are being evaluated concurrently, when plans and standards to evaluate a new service have not been established, or whenever there is uncertainty over such issues as the projected level of utilization, the accompanying patient charges, or the geographical area to be served. In addition, frequently as an outgrowth of negotiations with the CON reviewers, the applicant typically pledges additional actions that go beyond the specific proposal undergoing review—for example, that outreach efforts into indigent neighborhoods

157. Telephone conversation with Mark Knight of Wisconsin Division of Health, Department of Health and Social Services, December 22, 1978.

of rural communities will be initiated, or that an underutilized service in the same institution will be scaled down or eliminated.

Such commitments and projections may be said to constitute the conditions upon which the CON has been issued. It has been generally held that the power to approve includes the power to condition that approval, and the enforceability of these conditions has been upheld as long as they are reasonably necessary to effectuate the purposes of the statute.¹⁵⁸ Problems arise in the CON system, however, because of present inadequacies in assuring compliance with provider promises. As noted earlier, post-award monitoring of CON approvals is virtually nonexistent in most states. At the present time, neither Medicare nor Medicaid collect the data to cross-check actual levels of utilization with projected levels or to compare the amount of actual billed charges with the charge estimates presented in the CON application. Private third-

158. The analysis of conditional CON approvals prepared by Colorado Assistant Attorney General Frederick Yu is most instructive on this point. In a Memorandum to Colorado Health Facilities Review Council (September 6, 1978), Mr. Yu, in reviewing the Colorado CON statute, which was silent on the matter of conditional approvals, found strong authority for their issuance.

Courts have held in a number of cases that the power to approve includes the power to condition that approval. In *Southern Pacific Co. v. Olympic [sic] Dredging Co.*, 260 U.S. 205, . . . , the Secretary of War had approved construction of a new railroad bridge over a navigable river. The Secretary's approval was conditioned upon the removal of the old bridge. The U.S. Supreme Court said:

That the Secretary of War was authorized to impose a condition heretofore quoted does not admit of doubt. The power to approve implies the power to disapprove, and the power to disapprove necessarily includes the lesser power to condition an approval. In the light of this general assumption by Congress of control over the subject and of the large powers delegated to the Secretary, the condition imposed by that officer cannot be considered otherwise than as an authoritative determination of what was reasonably necessary to be done to insure free and safe navigation so far as the obstruction in question was concerned.

(emphasis added) 260 U.S. at 208.

It is worth noting that some courts have struck down conditions attached to varied forms of licensure. For example, in *New York University v. Temporary State Housing Rent Commission*, 304 N.Y. 126, 106 N.E.2d 44 (1952), the plaintiff University sought to evict a tenant to recover a building for use as a dormitory. The Rent Commission, as a condition to the issuance of a certificate of eviction, required the University, as the landlord, to relocate the evicted tenants. The court found that nothing in the statute or regulations authorized the Commission to impose such a condition, and that the condition was therefore unlawful. . . .

Whenever the Council wishes to impose a condition upon the issuance of a certificate, it must inquire whether the condition is "reasonably necessary to effectuate the purposes, scope, or stated terms" of the Certificate of Public Necessity Act. Where the Council finds such reasonable necessity, and does impose a condition, it would be worthwhile practice for the Council to make specific findings as to the basis for its decision to impose a condition, the reasonable necessity of the condition, and how the condition effectuates the purposes, scope or stated terms of the Act.

Id. at 2-3. Mr. Yu's analysis was based on the Colorado Administrative Procedure Act, which is comparable to the administrative procedure acts enacted in most other states; consequently, his analysis is applicable to many state-enacted CON programs.

party payors also do not look for these discrepancies. CON reviewers themselves do not customarily monitor projects after the award, generally having neither the inclination nor the resources.

Furthermore, once significant deviations from the original application have been found, it is not at all clear whether suitable remedies are available to CON reviewers or other parties. Absent the intentional filing of erroneous information, rescission of the CON itself would be extremely difficult, especially since CON statutes are generally silent on this point. It is also unlikely that courts would favor so drastic a penalty. Civil fines might be possible, but again specific statutory authority is lacking in virtually all CON laws. Discounting future CON proposals filed by the offending applicant might be attempted informally, but again, lacking statutory authorization, a CON agency may not be empowered to sanction providers in this manner. With change frequently outpacing the best of projections in the current health care industry, fraud or bad faith is exceedingly difficult to prove when discrepancies appear.

The best opportunity for both oversight and assuring compliance with the promises of a CON application lies with a prospective hospital budgeting system, most particularly with a state hospital ratesetting commission. Such commissions are generally bound to recognize CON projects in their hospital rate setting efforts.¹⁵⁹ In some states, however—most notably Maryland—this has resulted in an element of rivalry, if not bad feelings, between the CON and planning staff and their cost-conscious, budget-watching colleagues in the state hospital commission.¹⁶⁰ Nonetheless, through the use of this financial mechanism, a hospital could be held to comply with the specific charges, utilization figures, or purchase price proposed and approved in its CON application. The hospital commission would simply recognize only those costs that would have derived from the projections in the approved application—for example, the unapproved additional costs of a construction project would be excluded from the rate base. If actual utilization levels were lower than those projected, the higher unit costs would similarly be disallowed.¹⁶¹ The material representations made

159. See, e.g., COLO. REV. STAT. § 12-43.9-106(3)(c)(IV) (1978) (forces the hospital commission to recognize for a minimum of three years the full costs of a project that has received CON approval).

160. See H. Cohen, *supra* note 97.

161. Because of the high ratio of fixed to variable costs in most areas of the health sector, not allowing a hospital to raise its per unit charges when utilization is lower than expected and when

in the final (approved) version of the CON application could be binding for a minimum period such as three years—whether the commitment was made on the initiative of the provider, elicited by the CON reviewers, or was prompted by the competitive pressures arising out of a “batched” application format.¹⁶²

It may be appropriate before taking remedial action—whether through a ratesetting mechanism or through other means—to apply a screen or test to the provider who might simply have erred in completing its CON application. One criterion should be whether the erroneous information was material to the deliberations—that is, did the reviewers and other interested parties rely on it to such an extent that the project’s evaluation might have been different had the correct information been provided. To return to our earlier example, how important was it that the applicant indicated that it would be serving three counties rather than two? If, given the specific facts of the case, it is judged not significant by the CON decisionmaker, then the error could be excused. Nonetheless, there could be a cumulative effect of small mistakes that totally distorts the merit of a project or raises legitimate concerns about the competence of the party filling out the application forms. Ultimately, the integrity of a regulatory mechanism is threatened by erroneous information supplied to the decisionmaker—regardless of whether the source of the mistake was negligence or bad faith.

The other criterion that should be used is whether the inability to comply with the representations in the application resulted from circumstances clearly outside the control of the provider—if for example, a radiologist expected to join the hospital staff and run the CAT scanner was delayed at his earlier post and came to the hospital six months late, resulting in the machine being utilized for this period at a rate substantially below projections. Of course, even if the provider is

charges had been calculated on a higher, more optimistic utilization rate may constitute a considerable financial disincentive to the facility.

162. See, e.g., *National Nephrology Foundation v. Dougherty*, 138 N.J. Super. 470, 351 A.2d 392 (1976). In besting two other applicants, the successful applicant agreed to a condition sought by the CON decisionmaker—that it operate the renal dialysis center in “cooperation” with the local hospital, which also happened to be one of the rejected applicants. *Id.* at 475, 351 A.2d at 395.

In states where there is no prospective rate setting mechanism, other remedies will have to be examined, although none is likely to be as satisfactory as the one just described. A system of graduated civil fines is one possibility. See Butler, *Assuring the Quality of Care and Life in Nursing Homes: The Dilemma of Enforcement*, this Symposium, at text accompanying notes 209-45. Partial rescission of the CON is another.

found to be free of fault, some changes in the nature of a project may be significant enough that they should be brought back to the CON reviewing agency for further disposition.

A recent Colorado case involving a 400 bed hospital in Denver illustrates this point well.¹⁶³ The facility applied for and received a CON in March 1976 to obtain a CAT scanner for \$450,000. The hospital found after receiving the CON that the machine it had in mind would cost \$520,000, including installation. When the hospital sent its radiologists and neurologists to both the manufacturer's plant and a large medical center utilizing the machine, they discovered that it failed to meet specifications and would not serve the hospital's needs satisfactorily. The hospital cancelled its order and began to investigate other machines, all of which were found lacking. Finally the facility discovered a "third generation" scanner that had not even been introduced when the hospital first obtained its CON. More than a year after the CON was obtained, the hospital ordered the scanner, even though it cost \$700,000 and even though CONs in Colorado were effective for not more than twelve months.¹⁶⁴ When the Colorado CON agency learned of these activities, it sought additional clarifying information. The hospital went to court seeking injunctive relief from any proposed action by the state to block the hospital's acquisition, installation and utilization of the scanner. The state court, without ruling on the merits, found that the hospital would suffer irreparable injury—though it did not indicate how—if the hospital could not immediately use its newly delivered but still unpacked scanner. The court granted the hospital's request, and the scanner began full operations.

The major importance of the case is not whether the hospital was at fault for ordering a defective brand of CAT scanner—in the area of new medical technology, models are rapidly being superseded. Rather the issue is whether the hospital should have fully disclosed its difficulties to the CON decisionmaker and obtained its consent to exceed the approved price estimate by fifty percent and the twelve-month statutory limit for incurring a binding obligation.

163. *St. Joseph's Hosp. v. Colorado Dep't of Health*, No. C76578 (Denver Dist. Ct. Feb. 6, 1978).

164. See COLO. REV. STAT. § 25-3-509(1) (1973).

E. One Bite at the Apple: The Relevance of the Doctrines of Res Judicata and Substantial Evidence for CON Decisionmaking

With CON approval rates nationally in the ninety-percent range, it may seem premature to discuss reforms designed to assure that the CON system is not flooded with rehearings and extensive appeal hearings regarding projects that have been rejected after a full administrative proceeding. Nonetheless, if the stringency of the CON system does increase—as its boosters assert is not only likely but presently occurring¹⁶⁵—then the number of projects that will be denied is likely to increase markedly. This projected increase in rejections will undoubtedly give rise not only to a surge in appeals, but also to the development of “new” projects that will be nothing more than reworked versions of an already rejected project, with only cosmetic or trivial differences. These tactics are likely to be utilized primarily by wealthier applicants for whom the cost of prosecuting a CON application is relatively insignificant, especially since the costs of preparing an application are recoverable from third-party payors, including Medicare and Medicaid.¹⁶⁶

In the judicial system such “repeat” cases would likely be subject to the principle of *res judicata* for reasons of system efficiency and economy, certainty of outcome, and basic fairness, thus assuring that all parties—regardless of wealth—get only one day in court, that the adjudicatory system is not unduly taxed, and that the decisionmaking system is dispositive of controversies brought before it with parties barred from indulging in after-the-fact forum shopping.¹⁶⁷ In administrative adjudications, however, *res judicata* has been applied only narrowly, governed by the factual identity of the specific matter.¹⁶⁸

The traditional policy reasons for applying *res judicata* appear relevant to CON cases. Consequently, as a general approach, subject to discretionary exemptions, *res judicata* should be applied. In CON matters the significant facts and circumstances tend to be known and to be

165. See, e.g., Remarks of Joseph A. Califano, *supra* note 17, at 10; American Health Planning Association report, *supra* note 37, at 3.

166. See generally 42 C.F.R. § 405.451(b)(2) (1978), which recognizes as reimbursable under Medicare those “[n]ecessary and proper costs . . . which are appropriate and helpful in developing and maintaining the operation of patient care facilities and activities. They are usually costs which are common and accepted occurrences in the field of the provider’s activity.”

167. See F. JAMES & G. HAZARD, *CIVIL PROCEDURE* § 11.2 (2d ed. 1977).

168. K. DAVIS, *ADMINISTRATIVE LAW OF THE SEVENTIES* § 18.02 (1976).

relatively constant. Review criteria and plans are increasingly common for a growing number of services and projects and, at least for the short run, are not likely to change. Thus, barring a showing of great and unforeseen hardship, a project that has been considered and rejected by CON reviewers should be barred from resubmission for a substantial period of time, such as three years.¹⁶⁹ After that period, conditions may well have changed enough to justify a reexamination of the project if it is resubmitted.

It is more difficult to establish a definite policy for once-rejected CON projects that are resubmitted after being substantially modified or economically scaled down. A subsequent proposal may be substantially different from its predecessor even though it deals with the same general subject matter. For example, suppose that a general hospital has an underutilized wing that is licensed for use for general surgery patients. *Res judicata* should not bar the hospital from submitting a CON proposal to convert the wing from general surgery uses to general rehabilitative care even if a CON had already been denied on the basis of over-capacity in the community for an earlier CON application to convert the wing into one designated for heart catheterization and cardiac surgery. Little good to the public or the institution would be accomplished by freezing the wing's use for a period of time (perhaps as long as three years), especially since, with the exception of New York and Wisconsin where the power has never been exercised,¹⁷⁰ states at the present time are without the authority to decertify (that is, eliminate) a hospital's service. The wing would, in all likelihood, be of little value as an underutilized surgical area.

Another hypothetical, however, reveals the difficulty in devising a general rule. Let us assume a hospital is seeking a CON for two million dollars to construct a new wing to add twenty new intensive care beds. It is rejected on the grounds that less expensive alternatives were not explored. The facility then returns within six months with a project estimated to cost one million dollars that would involve converting an underutilized, already existing floor of the hospital into an intensive care service for fifteen beds. Should consideration of this second proposal be barred by *res judicata*?

169. See, e.g., 42 C.F.R. § 100.109(c)(1)(iii) (1977) (three-year limitation in 1122 program).

170. N.Y. PUB. HEALTH LAW § 2806-a (McKinney Cum. Supp. 1978). In Wisconsin the authority to decertify is limited to six specialized services: heart catheterization or cardiac surgery, radiation therapy, hemodialysis, kidney transplantation, intensive care and high risk neonatal services, and CAT scanning. WIS. STAT. ANN. § 150.41 to .48 (West Cum. Supp. 1978).

The adverse consequences of rejecting for review a less ambitious or less expensive version of an already rejected project could be considerable. It could well discourage an applicant from pursuing a more realistic approach in the first place. The incentive to settle for less, as has been noted repeatedly in this article, is already small in the health sector, especially for larger, wealthier providers. On the positive side, erecting a bar of some kind to such modified CON projects could, for appropriate projects, aid CON decisionmakers in achieving a mutually acceptable compromise with a project's proponents. Determining when to invoke such a bar and what the nature of it should be is worth further consideration and perhaps some experimentation. Conceivably, the bar should be applied whenever a new project deals with the same subject and involves no additional services, but has a lower cost or fewer beds. Or perhaps the bar should be an absolute one remaining in effect for one year rather than three, or it should be a relative one in which, operating under a capital expenditures lid, it would carry "penalty points" of some kind that would detract from the project's priority in obtaining an allocation of the state's annual budget for new capital expenditures.

Similar considerations of economy, certainty and fairness should also apply to the scope of appellate review rendered at both the administrative and judicial levels. Consequently, CON matters that have been appealed should be subject to the substantial evidence rule, so that review is limited to whether procedural due process was accorded, whether the action taken was within the agency's authority, and whether the decision was supported by substantial evidence in the record.¹⁷¹

The courts appear to have been diligent in exercising the self-restraint necessary in applying the substantial evidence rule to CON cases, although in several recent instances they have found the rule's minimum requirements not to have been met and have reversed the administrative decision resulting in the issuance of a CON.¹⁷² The defects in several of these cases were the same—there had been inadequate documentation in the record on why a specific standard had been

171. *See Saint Joseph's Hosp. v. Finley*, 153 N.J. Super. 214, 379 A.2d 467 (1978).

172. *See North Miami Gen. Hosp. v. Office of Community Medical Facilities*, 355 So. 2d 1272 (Fla. Dist. Ct. App. 1978); *Northwest Hosp. v. Illinois Health Facilities Planning Bd.*, 59 Ill. App. 3d 221, 375 N.E.2d 1327 (1978).

adopted,¹⁷³ and the standard had apparently been applied inconsistently to earlier applicants who, despite having violated the standard, had nonetheless received a CON.¹⁷⁴ The record in each of these cases failed to reflect what special merits these more fortunate applicants possessed or how those earlier cases could otherwise be distinguished.¹⁷⁵

While it is true that the substantial evidence rule has traditionally been applied to limit judicial review of final administrative action, it also has applicability for administrative appellate bodies and the reviews they conduct under current CON program requirements. After reviews at the HSA (and in some cases, the sub-HSA) level and a review and final administrative decision at the state level, there is still under federal law an additional administrative review before a disputed CON matter may be brought before the courts.¹⁷⁶ This additional step, which frequently has the potential for developing into a second full hearing,¹⁷⁷ promotes neither economy, certainty nor fairness.¹⁷⁸ Pennsylvania is presently seeking to amend its 1122 contract with HEW to limit the scope of review of this administrative appeal to bring it into accord with the judicial substantial evidence rule and, at a

173. See *North Miami Gen. Hosp. v. Office of Community Medical Facilities*, 355 So. 2d 1272 (Fla. Dist. Ct. App. 1978).

174. See *id.*; *Northwest Hosp. v. Illinois Health Facilities Planning Bd.*, 59 Ill. App. 3d 221, 375 N.E.2d 1327 (1978).

175. These recent judicial decisions regarding CON decisionmaking corroborate what Professor K.C. Davis noted in his recent work regarding the current status of general administrative law: "Developing the record" has become the central issue for administrative law in the 1970s. The record thus becomes the critical point for assuring general political accountability to the public and the legislature and in providing the courts with the necessary legal basis for exercising their limited review over administrative actions, including rulemaking, rate setting and adjudication.

K. DAVIS, *supra* note 168, at § 6.

176. 42 C.F.R. § 123.407(a)(9), (10) (1977) (CON requirements of P.L. 93-641); 42 C.F.R. § 106(c) (1977) (1122 requirements).

177. A hearing must be held at either the HSA or state level. 42 U.S.C. § 300n-1(b)(8) (1976).

178. See, e.g., *Somers & Somers*, *supra* note 42.

It is not easy to find a satisfactory balance between "due process," designed to provide maximum protection to the regulated parties, and administrative efficiency. In the New Jersey situation, however, it appears that "due process" has been too closely identified with multiple layers of bureaucratic review.

... Equity does require that denied applicants have a right of appeal within the administrative process. But such an appeal can rightly be confined to questions of "due process" to assure that all rights under the law have been respected and proper procedures have been followed. It does not require a complete reopening of all substantive questions . . .

Id. at 161. For a similar perspective from California, see S. Price, *supra* note 115, at 4: "In terms of procedure, what the state lacks by way of regulatory bodies it makes up for by over-using what it has. Everything is done twice."

minimum, to bar additional testimony at this level.¹⁷⁹ At the time of this writing, this approach has not been approved by HEW. Such limits on administrative appeals seem nonetheless advisable.

F. Keeping Future "CATs" in the Bag: The Case for Time-Limited or Site-Limited Moratoria for New Technology

In the aftermath of the CAT scanner phenomenon, with its explosive introduction, its short-lived generations of equipment, and the lingering questions about its efficacy,¹⁸⁰ one fact emerges clearly—with a new invention, it could all happen again. The forces that push providers toward embracing proliferating technology are, if anything, stronger than ever,¹⁸¹ and the capability of the overseers of the health system—the third-party payors, the planners and the regulators—to respond adequately to the next technological breakthrough remains minimal. Specifically, the staff of CON agencies, HSAs and SHPDAs, such as planners, statisticians, administrators and financial analysts, lack the resources and the training to conduct studies and analyze results on the effectiveness, efficacy and safety of new medical equipment. Incentives continue to exist for hospitals to compete among themselves not on the basis of price but largely through offering status and convenience (measured in part by providing the latest in medical technology) to its medical staff.¹⁸² Like other Americans, especially those with scientific training, many physicians continue to be intrigued with gadgetry and interested in labor-saving devices. Furthermore, physicians are concerned about malpractice and their potential liability if they fail to provide their patients with the latest in diagnostic and therapeutic services.

The advent of the new technology assessment capability in the Office of the Assistant Secretary of Health¹⁸³ and the increased activities of the Office of Technology Assessment in Congress, together with university-based research efforts into the subject, may begin to provide the basis for reviewing new technology *before* its massive introduction into the field. It has been estimated that forty percent of the increase in

179. See Proposed Rule § 8.14 (Scope of the fair hearing) in 8 PA. BULL. 452-53, 2305-06 (1976).

180. See OFFICE OF TECHNOLOGY ASSESSMENT, *supra* note 100.

181. See, e.g., authorities cited note 102 *supra*. See also H. Cohen *supra* note 97, at 7 (financial incentives to health institutions to lease new medical equipment for short periods rather than purchase it outright).

182. See Nelson & Winter, *supra* note 140.

183. Health Services Research, Health Statistics, and Health Care Technology Act of 1978, Pub. L. No. 95-623, 92 Stat. 3443 (to be codified in scattered sections of 42 U.S.C.).

hospital costs is a result of the introduction of new technology; if so, then for CON and other cost-containment mechanisms to succeed, a strategy for handling technology must be developed. This strategy must include analyzing, compiling and publishing research already performed on new technology, the funding of clinical trials and other methodologies that study the effectiveness as well as the efficiency of new equipment and procedures, and researching the technology development industry as well as the receptivity of health providers to new technology. Such research is necessary first to understand and then to influence the development, the deployment, and ultimately the use of technology in the health care sector. These issues must receive national attention. The work cannot be handled piecemeal without an overall coordinating point.

CON agencies must learn how to monitor closely the work of these national research projects and establish checks on the deployment of new technology until adequate evidence has been collected and evaluated on the usefulness of the projects. A limited moratorium may provide the best basis for evaluating some kinds of technology. By setting up one site in a state or region for public use of the new technology, the service can be made available on a limited, experimental basis while the usefulness of the technology is being fully examined. Alternately, a time-limited moratorium could be imposed, precluding any introduction of the technology into the state until evidence has been collected nationally showing it to be safe, efficient and medically cost-effective.

Precedents exist to support moratoria for planning and CON purposes;¹⁸⁴ however, several recent state court decisions suggest that it is questionable whether a moratorium could be imposed without formal rulemaking procedures.¹⁸⁵ Furthermore, to establish the *prima facie* reasonableness of the regulation, the agency should clearly set forth in the rulemaking hearing the purposes it hopes to serve by enacting the moratorium and the procedure to be utilized to review CON applications for the service in question.¹⁸⁶

184. *See Cooper River Convalescent Center, Inc. v. Dougherty*, 133 N.J. Super. 226, 336 A.2d 35 (1975).

185. *See North Miami Gen. Hosp., Inc. v. Office of Community Medical Facilities*, 355 So. 2d 1272 (Fla. Dist. Ct. App. 1978); *Cooper River Convalescent Center, Inc. v. Dougherty*, 133 N.J. Super. 226, 336 A.2d 35 (1975).

186. *See Cooper River Convalescent Center, Inc. v. Dougherty*, 133 N.J. Super. 226, 336 A.2d 35 (1975).

CONCLUSION

The solutions proposed in this article to strengthen the CON system are admittedly wide-ranging, eclectic, and in some areas, perhaps radical. The proposed remedies all tend to require greater intervention, but they are not merely premised on the assumption that all aspects of the health care industry should be brought under regulatory scrutiny and control. Several proposals were designed to bring efficiency, accountability and initiative to the CON mechanism. Others were aimed at stimulating market forces in the health care system and diffusing political opposition to sound but locally unpopular CON decisions. Some approaches sought to raise the consciousness level of parochial providers and consumers alike while protecting the right to due process of all interested parties. Finally, options were proposed to allow the system to function—or at least “muddle through”—until the quality and availability of health information, plans and criteria can be improved.

CON cannot be the panacea for the inflation that now ails the health care system. The roots of the problem are too numerous and too ingrained in our entire economy to be addressed by any single approach. CON is, at best, only a tactical device. Efforts to reform CON cannot take the place of efforts to develop a national health policy. However a national health policy is formulated—whether through the marketplace, centralized planning, or some mixture of both—it must establish priorities for the nation's health care system. We must seek to obtain better value for our current health expenditures. CON, together with other tools, may prove useful in administering priorities, eliminating waste and redundancy, and giving us better value for our health dollar.



ASSURING THE QUALITY OF CARE AND LIFE IN NURSING HOMES: THE DILEMMA OF ENFORCEMENT

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The elderly population of our society is growing at a rate greater than that of any other group,¹ but the number of extended families in which younger generations care for older ones is declining.² Approximately 1.5 million older Americans with chronic illness or disability, six percent of the population over sixty-five,³ now reside in nursing homes.⁴ Although many of the elderly infirm or disabled who require long-term health care could be served by noninstitutional services while living at home,⁵ the Medicaid and Medicare programs create almost insurmountable obstacles to the development and survival of outpatient long-term care providers and instead guarantee the continued existence of the nursing home as the primary provider of long-term health care services for the elderly, at least in the foreseeable future. Recent history demonstrates, however, that nursing homes in general provide neither a dignified, homelike, supportive atmosphere for their

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1. See Butler, *The Economics of Aging: Are We Asking the Wrong Questions*, 44 NAT'L J. 1792 (1978).

2. See F. MOSS & V. HALAMANDARIS, *TOO OLD, TOO SICK, TOO BAD: NURSING HOMES IN AMERICA* (1977). See also Levey & Amidon, *The Evolution of Extended Care Facilities*, NURSING HOMES, August 1967, at 14, 17.

3. See CONGRESSIONAL BUDGET OFFICE, *LONG-TERM CARE FOR THE ELDERLY AND DISABLED* 8 (Feb. 1977). Of the 25 million persons over 65 in the United States today, 5 million are chronically ill and require some form of long-term health care, while another 3 million are physically disabled. *Id.* Yet fewer than one-third are receiving care under formal programs, DEP'T HEW, OFFICE OF POLICY, PLANNING & EVALUATION, *STATISTICS* (1977), while the others receive care from families or no care at all.

4. A profile of these residents reveals that their average age is 82; 70% are over age 70, with the percentage of residents in this age bracket increasing; women outnumber men 3 to 1; only 10% have a living spouse; more than 50% have no close relatives; 96% are white; fewer than 50% are ambulatory; they remain in the nursing home an average of 2.4 years; at least 55% are mentally impaired; 33% are incontinent; more than 60% have no visitors at all; and only 30% will return home—some will transfer to other institutions, but many die in the nursing home. F. MOSS & V. HALAMANDARIS, *supra* note 2, at 8.

5. *Id.* at 18-19.

residents nor the rehabilitative services necessary to assist their residents in attaining a maximum level of functional capacity and independence.⁶ Since these services are arguably required as a condition of receiving public funds,⁷ both the residents and taxpayers, who furnish approximately one-half of the \$12 billion required to run these homes,⁸ are defrauded by their absence.

The task of establishing standards by which to measure the quality of care in nursing homes and a system of enforcing those standards has fallen to the state agencies that license nursing homes and certify their qualification to participate in Medicaid and Medicare. These standards, however, are usually patterned after those of hospitals and have generally emphasized physical facility structure and staffing ratios, disregarding the differences between the medical, residential, social and emotional needs of nursing home and hospital patients. The Medicaid program, which finances sixty percent of all nursing home costs,⁹ exacerbates this "medical model" by reimbursement policies that favor institutional rather than outpatient long-term care services. State agencies charged with the responsibility to enforce quality of care requirements have failed to administer even the standards that do exist because they are stymied by sluggish bureaucrats and limited, ineffective administrative remedies. This article will look at some possible

6. See SUBCOMM. ON LONG-TERM CARE OF THE SENATE SPECIAL COMM. ON AGING, NURSING HOME CARE IN THE UNITED STATES: FAILURE IN PUBLIC POLICY, INTRODUCTORY REPORT, S. REP. NO. 93-1420, 93rd Cong., 2d Sess. (1974) [hereinafter cited as INTRODUCTORY REP.]. See also AFL-CIO, AMERICA'S NURSING HOMES: PROFIT IN HUMAN MISERY (1977); BROWN, *An Appraisal of the Nursing Home Enforcement Process*, 17 ARIZ. L. REV. 304, 311-13 (1975); COLORADO ATT'Y GEN., REPORT CONCERNING THE REGULATION OF THE NURSING HOME INDUSTRY IN THE STATE OF COLORADO (1977); JOINT LEGISLATIVE AUDIT COMMITTEE, OFFICE OF THE AUDITOR GENERAL, REPORT TO THE CALIFORNIA LEGISLATURE, LONG-TERM CARE FOR THE AGED, PART II (1977); NEW YORK STATE MORELAND ACT COMMISSION, LONG TERM CARE REGULATION: PAST LAPSES, FUTURE PROSPECTS (1976); OHIO NURSING HOME COMMISSION, A PROGRAM IN CRISIS (1978) [hereinafter cited as OHIO REP.].

7. See INTRODUCTORY REP., *supra* note 6.

8. The nursing home industry currently receives over \$6 billion annually in government funds out of total revenues of \$12 billion. NATIONAL CENTER FOR HEALTH STATISTICS, DEP'T HEW, AN OVERVIEW OF NURSING HOME CHARACTERISTICS: PROVISIONAL DATA FROM THE 1977 NATIONAL NURSING HOME SURVEY, ADVANCEDATA FROM VITAL & HEALTH STATISTICS, No. 35 (1978) [hereinafter cited as ADVANCEDATA No. 35] at 6. Over \$5 billion of these funds come from Medicaid alone. INSTITUTE FOR MEDICAID MANAGEMENT, DEP'T HEW, DATA ON THE MEDICAID PROGRAM: ELIGIBILITY/SERVICES/EXPENDITURES FISCAL YEARS 1966-77 (1978) [hereinafter cited as MEDICAID DATA] at 31. Total government funding of nursing homes has increased 2000% since 1960 and is expected to reach \$9 billion in 1979. *Id.*

9. Classified by source of payment, nursing home residents nationally are supported 60% by Medicaid, 2% by Medicare and 38% by private sources. MEDICAID DATA, *supra* note 8, at 6-7. On the average, 40% of the nation's expenditures for Medicaid go to nursing home care; the percentage of these payments varies substantially from state to state from as low as 14% to as high as 77%. *Id.* at 42-43.

means by which regulating agencies and the public, including nursing home residents themselves, can improve the quality of nursing home care, as well as discuss some of the legal, political and practical difficulties they face in attempting to do so.

I. ENFORCING THE QUALITY OF CARE AND LIFE IN NURSING HOMES

A. State Licensing

The growth of the nursing home industry was spurred by the availability of federal funds under the Old Age Assistance provisions of the Social Security Act of 1935.¹⁰ Over the next fifteen years, thirty-five states began to license or otherwise regulate these facilities.¹¹ The impetus for state regulation was increased, however, by Congress' 1950 amendments of the Act, which permitted the payment of federal funds directly to the providers of care (called "vendors"), rather than to beneficiaries, on the condition that states establish and enforce standards for institutions receiving such funding.¹² In response to this legislation, the remaining states developed licensing systems for nursing homes.¹³ The state licensing standards were based on hospital standards¹⁴ and thus reflected the tenor of thinking in long-term health care—that the chronically ill and disabled in nursing homes primarily required medical intervention, albeit at a less intensive level than that provided by hospitals. They also reflected the contemporary view of how to regu-

10. 42 U.S.C. § 1396; (1976). See Wing & Craige, *Health Care Regulation: Dilemma of a Partially Developed Public Policy*, this Symposium, at text accompanying notes 116-19.

11. Lander, *Licensing of Health Care Facilities*, in ISSUES IN HEALTH LAW: A RESOURCE HANDBOOK (R. Romer & G. McKray, eds. 1979).

12. Social Security Act Amendments of 1950, ch. 809, § 303, 64 Stat. 477 (1950) (codified as amended in scattered sections of 42 U.S.C.). The 1935 Act, *supra* note 10, provided federal funds (to be matched by state funds) for income maintenance for the elderly and expressly prohibited payments for persons in public institutions. The existence of public funds, available for the first time to private boarding home owners, spurred a cottage industry of nursing homes. After more than a decade of experience, Congress recognized that a sufficient number of good homes did not exist and in the 1950 Amendments altered the limitation on the receipt of funds by public institutions to exclude only public nonmedical institutions, opening the door to the development of public nursing care facilities. See CONGRESSIONAL RESEARCH SERVICE, NURSING HOMES AND THE CONGRESS: A BRIEF HISTORY OF DEVELOPMENTS AND ISSUES, HD7106D (1972) [hereinafter cited as CONGRESSIONAL RESEARCH SERVICE]; Levey & Amidon, *supra* note 2, at 17.

13. See Lander, *supra* note 11. State licensing authority has been upheld against constitutional challenge as a proper exercise of the state's police power to promote public health and protect public safety. See, e.g., *Dent v. West Virginia*, 129 U.S. 114 (1888); *Goodwin v. Oklahoma*, 436 F. Supp. 583 (W.D. Okla. 1977); *Father Basil's Lodge, Inc. v. City of Chicago*, 393 Ill. 246, 65 N.E.2d 805 (1946).

14. DEP'T HEW, LONG-TERM CARE FACILITY IMPROVEMENT STUDY: INTRODUCTORY REPORT 3 (1975) [hereinafter cited as IMPROVEMENT STUDY].

late quality of care in acute care settings in their emphasis upon standards for the physical plant and the numbers and type of staff to attend hospital patients, standards that were later to be characterized as "structural."¹⁵

B. Medicaid and Medicare Certification

1. The Medicaid and Medicare Programs

The Medicaid and Medicare programs, which were established by the 1965 amendments to the Social Security Act,¹⁶ were conceived amidst a long and bitter debate between forces attempting to develop a comprehensive health insurance program for the elderly and those opposing all federal intervention in delivering health care. In a compromise designed to enlist the support of competing interest groups, congressional leaders developed a three-part program. Medicare, Title XVIII of the Social Security Act, had two parts: Part A, Hospital Insurance for the Aged, which paid for a specified number of hospital, nursing home and home nursing services, was financed and administered by the Social Security Administration and was designed to please the hospital lobby; and Part B, Supplementary Medical Insurance, which was financed through individual premiums and administered through private insurance carriers, paid for physicians' services according to their "usual and customary" fees, and was designed to attract support from the medical profession and the insurance industry. Medicaid, Title XIX of the Social Security Act, was drafted at the end of four years of debate over health insurance for the elderly. It provided a broad range of services to the indigent and was jointly administered and funded by the state and federal governments. Medicaid was designed to appease numerous interests, including state and local governments, the medical establishment, and the hospital industry, all of which felt that they had borne too great a burden in providing charity care in the previous decade. Medicaid extended the existing welfare vendor payment system, which previously had paid for health care for welfare recipients, to groups of non-welfare recipients as well.

Although nursing home standards for Medicaid and Medicare became identical under the 1972 Social Security amendments,¹⁷ the two

15. See note 65 and accompanying text *infra*.

16. Social Security Act Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286 (1965) (codified as amended in scattered sections of 42, 45 U.S.C.).

17. Social Security Act Amendments of 1972, Pub. L. No. 92-603, § 246, 86 Stat. 1329 (1972) (codified as amended in 42 U.S.C. §§ 1395x(j), 1396a(a)(38) (1976)).

programs are quite distinct, serving different population groups and providing a different scope of nursing home benefits. Medicare is drafted to resemble a health insurance program. All recipients of Social Security payments who reach age sixty-five¹⁸ or have received social security disability payments for twenty-four months¹⁹ are eligible for Part A of the Medicare program, which provides limited hospital services²⁰ and services in a skilled nursing facility for up to 100 days²¹ per "spell of illness,"²² but only for persons hospitalized for the same illness for at least three days. Nursing homes under Medicare were originally called "Extended Care Facilities" (ECFs), denoting the original concept of a short-term, less intensive "extension" of a hospital stay. Part A also provides home health care—the services of visiting nurses and nurse's aides for persons discharged from a hospital or nursing facility.²³ Part B of the Medicare program, for which persons over 65 or disabled must pay a monthly premium,²⁴ finances physician services and home health care services without the prerequisite institutionalization required by Part A.²⁵

Medicaid serves an entirely different population: persons receiving welfare under one of the federal categories—the aged, blind or disabled, or families with children deprived of parental support (the "categorically needy").²⁶ States may also cover persons physically "linked" to those categories whose incomes exceed the welfare eligibility levels, yet who are unable to meet the costs of health care (the "medically needy").²⁷ States choose to participate in Medicaid and design their systems individually, within the parameters of federal requirements regarding eligibility, benefits, payment for providers of health care and standards for provider participation.²⁸ Medicaid law

18. 42 U.S.C. §§ 1395c, 426(a) (1976).

19. *Id.* §§ 1395c, 402(d)-(f), 423.

20. *Id.* § 1395d(a)(1).

21. *Id.* § 1395d(a)(2).

22. A spell of illness is an acute illness requiring institutionalization; it ends after 60 days have passed in which the Medicare beneficiary was not an inpatient of a hospital or nursing home. *Id.* § 1395x(a).

23. *Id.* § 1395d(a)(3).

24. *Id.* §§ 1395p, 1395r.

25. *Id.* §§ 1395k(a), 1395x(s).

26. *Id.* §§ 1396, 1396a(a)(10)(A).

27. *Id.* § 1396a(a)(10)(C).

28. At the state level, Medicaid is administered by a "single state agency," *id.* § 1396a(a)(5) (1976), which is often the state welfare agency but rarely the state health department. The federal government shares between 50% and 83% of the cost of the program's administration. *Id.* § 1396d(b). Medicaid law also requires states to provide certain basic services: inpatient and outpatient hospital services, physician services, x-ray and laboratory services, skilled nursing

requires that all states pay for care in skilled nursing facilities (SNFs), and permits coverage of care in intermediate care facilities (ICFs).²⁹

2. Development of Medicaid Standards and Medicare Conditions of Participation

The Medicaid statute did not set standards for nursing homes, but left that task primarily to each state, with the congressional directive to improve quality of care standards and enforcement.³⁰ Originally, the Department of Health, Education and Welfare (HEW) required states to apply Medicare standards for ECFs to Medicaid nursing homes.³¹ But after congressional pressure and the enactment of a minimum set of statutory Medicaid nursing home requirements in 1968, HEW adopted regulations that established much less stringent conditions for Medicaid-certified nursing homes.³²

facility services, and family planning and early childhood screening services. *Id.* § 1396d(a)(1)-(5). States may also choose to provide, with matching federal funds, various optional services, including drugs, prosthetic devices, dental care and intermediate care facility services. *Id.* § 1396d(a)(6)-(17).

29. *Id.* § 1396d(a)(15). ICFs are institutions that provide less intensive nursing care than SNFs, and therefore presumably serve a more functional and less ill population. The average SNF under Medicaid and Medicare contains 100 beds; the average Medicaid ICF contains 57 beds. Kane & Kane, *Care of the Aged: Old Problems in Need of New Solutions*, 200 SCIENCE 813, 814 (Table 1) (1978). All nursing care facilities average 64 employees per 100 beds. This profile contrasts sharply with that of the average American hospital, which has 160 beds and 243 employees per 100 beds. *Id.* ICF services were added to the Medicaid program in 1971. Act of Dec. 28, 1971, Pub. L. No. 92-223, § 4(a), 85 Stat. 809 (1971) (codified at 42 U.S.C. § 1396d (1976)).

30. S. REP. NO. 404, 89th Cong., 1st Sess. 76 (1975).

31. DEP'T HEW, HANDBOOK OF PUBLIC ASSISTANCE ADMINISTRATION, cited in *President's Proposal for Revision in the Social Security System: Hearings on H.R. 5710 Before the House Ways and Means Comm.*, 90th Cong., 1st Sess. 355 (1967) [hereinafter cited as *Hearings on H.R. 5710*].

32. 33 Fed. Reg. 16,165 (1968); 34 Fed. Reg. 9788 (1969). The American Nursing Home Association, representing proprietary facilities and joined by many congressional leaders, argued that HEW was not authorized to establish national standards. *Hearings on H.R. 5710, supra* note 31, at 353-58. In a sharply worded rebuttal, former HEW Secretary Wilbur Cohen testified before the House Ways and Means Committee that the agency did indeed have the power to issue fairly detailed nursing home standards for Medicaid participation. *Id.* at 353-63. The 1967 Social Security Amendments to Medicaid and Medicare included requirements that state Medicaid programs compel nursing homes to maintain an organized nursing service, plan menus, maintain satisfactory policies and procedures for medical records, drugs, physician care and emergency medical services, set up a transfer agreement with a hospital, and comply with the 1967 Life Safety Code. Social Security Amendments of 1967, Pub. L. No. 90-248, § 234(a), 81 Stat. 906 (1968) (codified at 42 U.S.C. § 1396a (1976)); see *Hearing Before Senate Finance Comm. on H.R. 12080*, 90th Cong., 1st Sess. 893-97 (1967). Since these standards were narrower than those under Medicare, HEW may have felt that their adoption undermined its earlier posture. It first published guidelines and later adopted formal regulations on nursing home standards in which it retreated from requiring application of the Medicare standards and established much less stringent conditions for Medicaid nursing homes. 33 Fed. Reg. 16,165 (1968); 34 Fed. Reg. 9788 (1969).

In 1969, Senator Frank Moss, chairman of the Long-Term Care Subcommittee of the Senate Special Committee on Aging, began a series of thirty hearings on problems in the nursing home industry. *Senate Special Comm. on Aging, Trends in Long-Term Care: Hearings Before the*

Medicare certification standards, called "Conditions of Participation," were developed in 1966 and revised in 1974.³³ They followed the pattern set by state licensing standards of the 1950's and the perspective that persons in Medicare nursing homes primarily required *medical* services. The standards were developed under the "hospital model," regulating the physical and staffing structure of the facilities and requiring the existence of written policies and procedures.³⁴

After the 1972 Social Security amendments, which provided a common definition of skilled nursing facilities under both Medicaid and Medicare, HEW issued regulations establishing eighteen "Conditions of Participation" to be applied to SNFs that are certified under either program. These conditions include standards for administration, resident services, sanitation and physical plant.³⁵

Subcomm. on Long-Term Care of the Senate Special Comm. on Aging, 91st-94th Congresses (1969-1975). The hearings resulted in a seven-volume report that revealed scandalous problems of fire safety violations, patient abuse, financial mismanagement and corruption and a shockingly low quality of care in the nation's nursing homes, combined with a total failure by HEW and the states to adopt standards and enforcement techniques to provide protection against those abuses. The Subcommittee on Long-Term Care drafted nine supporting papers to its overall report. *THE LITANY OF NURSING HOME ABUSES AND AN EXAMINATION OF THE ROOTS OF CONTROVERSY* (1974); *DRUGS IN NURSING HOMES: MISUSE, HIGH COSTS, AND KICKBACKS* (1975); *DOCTORS IN NURSING HOMES: THE SHUNNED RESPONSIBILITY* (1975); *NURSES IN NURSING HOMES: THE HEAVY BURDEN* (1975); *THE CONTINUING CHRONICLE OF NURSING HOME FIRES* (1975); *WHAT CAN BE DONE IN NURSING HOMES: POSITIVE ASPECTS OF LONG-TERM CARE* (1975); *THE ROLE OF NURSING HOMES IN CARING FOR DISCHARGED MENTAL PATIENTS* (1976); *ACCESS TO NURSING HOMES BY U.S. MINORITIES* (1976); and *PROFITS AND THE NURSING HOME: INCENTIVES IN FAVOR OF POOR CARE* (1976).

33. 42 C.F.R. § 405.1101, .1120-.1137 (1977). After a 1953 congressional study under the auspices of the Hill-Burton Hospital Construction program revealed that out of 25,000 long-term care institutions, only 7,000 provided "skilled nursing care," Congress amended the Hill-Burton Act to provide federal construction funding for long-term care facilities that were connected to hospitals or run by public or non-profit organizations. CONGRESSIONAL RESEARCH SERVICE, *supra* note 12, at 21. A further congressional study in 1956 disclosed a uniformly poor quality of care. *Id.* at 22. These findings were confirmed by a 1960 congressional report that cited problems of untrained administrators and aides, too few staff, limited services (especially rehabilitation), lack of physician attendance or medical supervision, inadequate state licensing programs and gross safety hazards. SUBCOMM. ON PROBLEMS OF THE AGED AND AGING OF THE SENATE COMM. ON LABOR & PUBLIC WELFARE, *THE AGED AND AGING IN THE UNITED STATES: A NATIONAL PROBLEM*, S. REP. NO. 86-1121, 86th Cong., 2d Sess., Pt. VII (1960). In response to these findings, Congress, with the adoption of Medicaid and Medicare in 1965, required that nursing homes participating in Medicare comply with specified federal standards. Social Security Act Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286 (1965) (codified as amended in scattered sections of 42, 45 U.S.C.). The Conditions of Participation are the standards established as a result of this directive. See 42 C.F.R. § 405.1101 (1977).

34. See IMPROVEMENT STUDY, *supra* note 14, at 3, 14-15.

35. The Conditions of Participation set standards for (1) state licensure; (2) governing body and management (including patients' rights); (3) medical direction; (4) physical services; (5) nursing services; (6) dietetic services; (7) specialized rehabilitative services; (8) pharmaceutical services; (9) laboratory and X-ray services; (10) dental services; (11) social services; (12) patient activities; (13) medical records; (14) transfer agreement; (15) physical environment; (16) infection control; (17) disaster preparedness; and (18) utilization review. 42 C.F.R. § 405.1120-.1137 (1977). In June

3. Meeting Certification Requirements

State Medicaid agencies and HEW are required to certify skilled nursing facilities as fully complying with the Medicaid-Medicare certification standards.³⁶ Facility inspections, which may be unannounced,³⁷ are performed by state facility licensing agencies (usually state health departments) under contract with HEW and Medicaid agencies.³⁸ Teams of surveyors composed of nurses, sanitarians, administrators and engineers perform a physical inspection of nursing home premises, interview patients and staff, and examine documents and records. If state inspectors discover deficiencies, they submit a "deficiency list" to the facility, which must in return file a "plan of correction" with the agency, proposing a reasonable schedule for its correction of the deficiencies. The state agency then visits the facility again to determine whether the deficiencies have been corrected and

1978. HEW published a notice of its intent to develop new standards, along with "draft specifications," and a schedule of regional public hearings to entertain comments on the draft and the need for new regulations. 43 Fed. Reg. 24,873 (1978).

36. 42 C.F.R. § 405.1908 (1977); 43 Fed. Reg. 43,235 (1977) (to be codified in 42 C.F.R. § 442.110(a)).

37. Some states expressly require unannounced inspections. See CAL. HEALTH & SAFETY CODE § 1421 (West Cum. Supp. 1978); IOWA CODE ANN. § 135C.39 (West Cum. Supp. 1978); KAN. STAT. § 39-935(4) (Cum. Supp. 1978); MINN. STAT. ANN. § 144A.10(2) (West Cum. Supp. 1978). The use of unannounced nursing home inspections was upheld in California against a challenge based on the fourth amendment protection against unlawful searches and seizures in *People v. White*, 65 Cal. Rptr. 923, 259 Cal. App. 2d 936 (1968). A nursing home owner convicted of a misdemeanor for not keeping 40 hours of registered nurse coverage, as required by state law, challenged the unannounced inspection that formed the basis of the conviction. The court had to contend with the recent Supreme Court cases of *Camara v. Municipal Court*, 387 U.S. 523 (1967), and *See v. City of Seattle*, 387 U.S. 541 (1967), which invalidated searches under state police powers. The California court held that "searches or seizures made pursuant to licensing statutes which require inspection are valid and not subject to constitutional objection," on the grounds that the licensee had consented to inspections as a condition of licensure and that the facility was open to the public. The court said that "acceptance of a license to operate a hospital is an implied consent to such supervision and inspection as is required by the licensing statute involved." 65 Cal. Rptr. at 927, 259 Cal. App. 2d at 939.

The recent Supreme Court case of *Marshall v. Barlow's, Inc.*, 436 U.S. 307 (1978), invalidating as a violation of the fourth amendment warrantless inspections by the Department of Labor under the Occupational Safety and Health Act of 1970, does not undercut the holding in *White*. The Supreme Court held that an exception to the fourth amendment's requirement of a search warrant exists in cases of "pervasively regulated businesses" in which each owner has "voluntarily chosen to subject himself to a full arsenal of governmental regulation." *id.* at 313, the second ground of the decision in *White*. Moreover, one of the reasons for the *Marshall* Court's application of the warrant requirement to OSHA inspections was that such a requirement would not hamper OSHA's enforcement. *Id.*; see Note, 57 N.C.L. REV. 320, 329-30 (1979). Although Federal law permits, but does not require, unannounced nursing home inspections, at least one state has found them necessary for meaningful enforcement of the Medicaid-Medicare certification standards, OHIO REP., *supra* note 6, at 23, and the reasoning of the Court in *Marshall* therefore should not apply to such inspections.

38. 42 U.S.C. §§ 1395aa(a), 1396a(a)(33) (1976).

whether others have developed. If, in the opinion of the state inspectors, the facility complies with the federal standards, it recommends that HEW certify the facility for participation in Medicare and that the state Medicaid agency certify it for participation in Medicaid. If HEW accepts this recommendation, it will execute a one-year Provider Agreement with the facility that entitles it to accept Medicare patients and receive reimbursement for them.

Institutions are now required by law to comply with the Medicaid-Medicare standards in order to be certified to participate in either program. The regulations, however, permit a facility with deficiencies to be certified if the deficiencies do not jeopardize patient health and safety nor seriously limit the facility's capability to provide adequate care and if it submits an acceptable plan for correcting the deficiencies within twelve months of inspection.³⁹ If the same deficiency is apparent during a subsequent certification period, the nursing home cannot be certified for continued Medicare or Medicaid participation unless it was in compliance at some time during this subsequent period, made a "good faith effort" to comply and was unable to do so "for reasons beyond its control."⁴⁰ The state agency must document the evidence in support of these required findings.⁴¹

A facility with deficiencies may be certified for fewer than twelve months under the above conditions. In addition, the Medicaid agency or HEW may certify a facility for a period ending not more than sixty days after the last day specified in its plan for correcting the deficiencies or may issue a conditional certification with an automatic cancellation clause.⁴² The certification would thus expire upon the condition subsequent that the facility had not made substantial progress in correcting the deficiency by a certain date, which must be no longer than sixty days after the date for correction in the plan of correction.⁴³

Nursing home certification under Medicaid was traditionally handled differently from that under Medicare, but since the 1972 Social Security Act amendments⁴⁴ the two systems have been identical. Orig-

39. 42 C.F.R. §§ 442.105(a), (b), 405.1905(a), 1907(a) (1977).

40. *Id.* §§ 405.1908(d), 442.105(d).

41. *Id.* §§ 405.1903, 442.105(a). That the certifying agency has only these choices and must document them in its records suggests that, despite the recognized doctrine of prosecutorial discretion, an agency could be required to take some action against facilities not meeting the certification conditions.

42. *Id.* §§ 405.1908(a), 442.111(b), (c).

43. *Id.*

44. Social Security Amendments of 1972, Pub. L. No. 92-603, § 246, 86 Stat. 1424-25 (1972) (codified in scattered subsections of 42 U.S.C. §§ 1395, 1396 (1976)).

nally, the state Medicaid agency (often the state welfare department rather than the health department) was required to survey facilities for participation under Medicaid. Sometimes state Medicaid agencies contracted with state licensing agencies to perform this function, but such arrangements were not mandatory. Furthermore, states developed their own Medicaid nursing home certification standards, which were not necessarily identical to those under Medicare. Concern over recognized problems of the quality of care in nursing homes and the inefficiency of different standards and survey processes among state licensing and certification agencies prompted Congress in 1972 to consolidate ECFs under Medicare and SNFs under Medicaid into the single rubric of "skilled nursing facility."⁴⁵ In addition to adopting a single set of nursing facility standards, Congress required that the state licensing agency inspect and recommend certification for both Medicaid and Medicare, ending the bifurcation of this function in some states. SNFs certified by HEW to participate in Medicare are automatically qualified for Medicaid participation.⁴⁶ They must, however, execute separate annual Provider Agreements—one with HEW for Medicare and one with the Medicaid agency. Facilities choosing to serve only Medicaid beneficiaries must be certified by the state Medicaid agency, with HEW determining compliance with Life Safety Code requirements.⁴⁷

State Medicaid agencies certify intermediate care facilities under circumstances similar to those for certification of SNFs.⁴⁸ The federal regulations, however, contain special provisions for certifying ICFs with deficiencies in environmental, sanitation, Life Safety Code and physical space standards.⁴⁹

In 1972 Congress also mandated the payment of the entire cost of the state survey-certification process under Medicaid out of federal

45. Social Security Amendments of 1972, Pub. L. No. 92-603, § 248A, 86 Stat. 1424-25 (1972) (codified at 42 U.S.C. §§ 1395x(j), 1396a(a) (38) (1976)).

46. Social Security Amendments of 1972, Pub. L. No. 92-603, § 248, 86 Stat. 1424-25 (1972) (codified at 42 U.S.C. § 1396a(a) (1976)).

47. In proposing this amendment, the Senate Finance Committee stated that it was not intended to result in any dilution or weakening of standards for skilled nursing facilities. As at present, a State may continue to require higher standards of skilled nursing facilities than those mandated by Federal statute and regulation. Where a State imposes additional requirements in its own right, then, as under the present section 1863, those standards would apply to both Medicare and Medicaid skilled nursing facilities in the State.

S. REP. NO. 92-1230, 92d Cong., 2d Sess. 281-82 (1972).

48. 42 C.F.R. §§ 442.30, .105, .111 (1977).

49. *Id.* §§ 442.112, .113.

funds.⁵⁰ Medicare survey costs had always been exclusively federally funded, but prior to 1972 Medicaid survey costs had only been matched at the administrative matching rate of seventy-five percent.⁵¹ By paying one hundred percent of the costs of surveying and certifying SNFs under Medicaid and by adopting federal standards for SNF certification and the surveying process, Congress made a major commitment to enforcing quality of care and life in the nation's nursing homes.

II. PROBLEMS IN QUALITY OF CARE ENFORCEMENT

There are several theories about the forces that operate in a regulated industry. One theory is that the regulators are captured by the regulated industry and champion its objectives.⁵² For example, it is often alleged that federal regulatory agencies, such as the Interstate Commerce Commission and the Civil Aeronautics Board, advocate the interests of the regulated industry rather than the public interests they were presumably established to protect.⁵³ Another theory is that the regulated industries demand regulation, such as professional licensure, in order to maintain a market monopoly.⁵⁴ Still other theorists maintain that the regulatory bureaucracy itself drives and sustains the initiative for regulation.⁵⁵ For instance, one study of the demand for licensing clinical laboratory technicians in California concluded that the state licensing agency rather than the public or the licensees initially demanded and then sustained interest in regulating this profession.⁵⁶ It is possible to find all these forces at work in the life cycle of a regulatory process: a regulatory system is born out of public pressure to solve an identified social problem; initially, the established agency handles problems aggressively and creatively, but is faced with mounting pressure from the regulated activity; the agency loses vocal and ac-

50. Social Security Amendments of 1972, Pub. L. No. 92-603, § 239, 86 Stat. 1424-25 (1972) (codified at 42 U.S.C. § 1396b(a)(4) (1976)).

51. 42 U.S.C. § 1396b(a)(2) (1976).

52. See M. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION 25-49 (1955); Jaffe, *The Effective Limits of the Administrative Process: A Reevaluation*, 67 HARV. L. REV. 1105 (1954); Navarro, *Social Class, Political Power, and The State*, 1 J. HEALTH POL., POL'Y & L. 256 (1976); Posner, *Theories of Economic Regulation*, 4 BELL J. ECON. & MANAGEMENT SCI. 335 (1974).

53. Jaffe, *supra* note 52, at 1109-1113.

54. Stigler, *The Theory of Economic Regulation*, 5 BELL J. ECON. & MANAGEMENT SCI. 1, 3-21 (1971). The Federal Trade Commission is investigating the monopolistic potential of health personnel licensure.

55. Wilson, *The Dead Hand of Regulation*, 25 THE PUBLIC INTEREST 39, 47-48 (1971).

56. W. WHITE, PUBLIC HEALTH AND PRIVATE GAIN: THE ECONOMICS OF LICENSING CLINICAL LABORATORY PERSONNEL (1979).

tive public support and becomes devitalized, adjusting to an atmosphere in which it functions less as a regulator and more as a consultant-manager and begins to be the captive of the regulated industry; the agency is abandoned by the public and does not undertake an active regulatory role; finally, with diminished funding, public support and internal initiative, the agency becomes debilitated and ineffectual.⁵⁷

The nursing home enforcement processes in most states are characterized by this regulatory life-cycle. Despite periods of creative and aggressive enforcement, most licensing agencies are ineffective because of inadequate funding, apathetic personnel, cumbersome legal remedies, inappropriate standards, interagency fragmentation and maldistribution of long-term care resources. Enforcement agencies are generally underfunded and thus limited in the personnel available to perform adequate inspections. This situation has developed because many state licensing agencies are financed almost exclusively with the one hundred percent federal funding available for the inspection process. Unlike the costs of Medicaid *program* services, which are reimbursed on the basis of all actual expenditures,⁵⁸ however, inspection costs are reimbursed in response to fixed annual budgets, which state survey agencies must submit to and negotiate with regional HEW offices. Colorado, for instance, whose state licensing standards are similar to the federal conditions of participation, performs few independent state licensing functions. Its licensing responsibilities are subsumed within its federal certification duties. The state relies on over ninety percent federal funding for its state licensing and Medicare-Medicaid certification budget.⁵⁹ Thus, the availability of federal funds directly determines the extent of the state's nursing home enforcement efforts under even its own licensing power.

Because of budgetary limitations and limited enforcement powers,⁶⁰ agency personnel often become frustrated by a lack of a real ability to improve nursing home quality, and this frustration leads to apathy. Nursing home inspectors also face a dilemma of roles, uncertain whether they are "police" or "consultants."⁶¹ When the public is not regularly confronted with the immediate and shocking problems in

57. Ruchlin, *A New Strategy for Regulating Long-Term Care Facilities*, 2 J. HEALTH POL., POL'Y & L. 190, 191 (1977).

58. See notes 50-51 and accompanying text *supra*.

59. See COLORADO ATT'Y GEN., *supra* note 6.

60. See text accompanying notes 142-169 *infra*.

61. OHIO REP., *supra* note 6, at 24.

the industry, public support for regulatory efforts diminishes. This lack of active public support, combined with the industry's criticism of the regulators and the fact that inspectors' daily contacts are only with the regulated facilities, makes it difficult for inspectors to see themselves as purely objective public servants. There has been a pronounced tendency by surveyors to seek good relationships with, if not cater to, the nursing homes they regulate.

The lengthy and complicated legal process accompanying revocation of nursing home licenses or certification also delays effective regulation and deters agencies from taking aggressive steps. Facilities have succeeded in applying due process concepts to elevate owners' rights over the patients' interests, which enforcement agencies purport to protect.⁶² Courts require a high standard of proof to sustain agency revocation of a state license or a Medicaid certification and have resisted efforts to enforce licensing and certification standards that are vague or subjective.⁶³

Effectiveness of the regulatory system is further compromised by the fragmentation that exists among regulatory agencies; even after the 1972 Social Security amendments integrating Medicaid and Medicare enforcement, many states have several agencies responsible for establishing and enforcing nursing home standards. In many states one agency may issue certificates of need to build facilities or set facility rates, another may license and recommend certification of facilities, another may reimburse under Medicaid, another may license health professionals, another may inspect for fire safety and another may place adults in facilities, while Professional Standards Review Organizations (PSROs) may perform medical review, and the state attorney general's office may spearhead actual enforcement. At the federal level, HEW reimburses under Medicare and uses its own system to enforce compliance or revoke certification.⁶⁴ Government tends to solve quality of care problems by adding more agencies rather than consolidating and reforming existing ones. Not only is interagency communication and data sharing usually inadequate or altogether nonexistent, but the power of Medicaid reimbursement as a quality assurance tool⁶⁵ is often lost when the Medicaid agency is not the licensing-certification agency.

62. See notes 129-155 and accompanying text *infra*.

63. OHIO REP., *supra* note 6, at 20.

64. NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, ENFORCING QUALITY OF CARE IN NURSING HOMES 10-12 (1978) [hereinafter cited as NAAG REP.].

65. See notes 90-122 and accompanying text *infra*.

Distribution of long-term health care resources also has a negative impact upon regulation if a state or an area is undersupplied with nursing home beds. In many rural communities with only a single nursing home, it is politically and practically impossible to close a facility; the lack of alternative enforcement remedies poses a serious problem in those situations. The absence of noninstitutional alternatives to nursing homes, resulting largely from the institutional bias of Medicaid and Medicare, further aggravates the ineffectiveness of nursing home enforcement.

III. POSSIBILITIES FOR REFORM

A number of options exist for reform of the existing regulatory processes that attempt to control the quality of care in nursing homes: (a) elimination of existing programs and increased reliance on competition among providers of nursing home services; (b) change in the focus of regulation to provide new and challenging functions for regulators in order to revitalize the moribund regulatory system; (c) development of economic incentives for individual nursing homes to provide high quality care; (d) enhancement of enforcement mechanisms to provide regulators a greater array of enforcement remedies; and (e) increased public support for and involvement in the regulatory process. The remainder of this article will examine each of these options, most of which are complementary, not exclusive.

A. Stimulating Competition in an Unregulated Market

There is little reason to believe that elimination of regulatory programs and reliance on market place competition will operate to improve the quality of care, given the present structure of the nursing home industry and the means by which it is currently financed.⁶⁶ Without truly informed consumer judgment and complete freedom of choice, which will not exist if there is a shortage of facilities or noninstitutional alternatives in an area, simply eliminating the regulatory processes seems inappropriate. Consumers of nursing home services are not in a position to judge quality, since they are usually ill and often impaired. Furthermore, unless accurate quality indices are developed and made available to the public, individual consumers are incapable of identifying high quality homes in their area that will meet

66. Ruchlin, *supra* note 57, at 199-200.

their needs.⁶⁷ Even if consumers were informed about quality of care in various institutions and if sufficient beds were available to permit them to exercise a real choice, consumers often could not make an informed decision about whether to enter a nursing home without access to noninstitutional alternatives. It is estimated that at least one-third of the nursing home population is inappropriately placed and would be capable of remaining in a residential setting if supportive services such as social services, homemaker services, home health services and recreational activities were available to them.⁶⁸

The insufficient supply of noninstitutional long-term care results primarily from the failure of its funding by Medicaid and Medicare. There have been some proposals to expand Medicare home health care services.⁶⁹ A few Medicaid demonstration projects, providing adult day care services and other non-traditional health care services for the elderly and disabled, have been federally funded.⁷⁰ These few projects can hardly be expected to serve even a fraction of the nursing home population that is inappropriately placed.

The existence of a spectrum of alternatives in long-term health care, along with informed awareness, could provide the competitive circumstances that would compel nursing homes to provide visible, high-quality care at a reasonable cost. But conditions do not currently exist to permit competition alone to assure nursing home quality of care without some form of active government intervention.

B. *Changing the Regulatory Focus*

Some regulation must exist in the long-term health facility field in order to assure quality of care, but the current regulatory mechanisms apparently cannot achieve this objective. It might be possible to mini-

67. OHIO REP., *supra* note 6, at 16-17.

68. The Congressional Budget Office, for example, estimated that 10-20% of SNF residents and 20-40% of ICF residents are placed at too high a level of care and that many could be cared for at home or in sheltered living arrangements. CONGRESSIONAL BUDGET OFFICE, *supra* note 3, at 18-19.

69. Proposed H.R. 13097, 95th Cong., 1st Sess. (1975) would have eliminated limitations on home care services under Medicare.

70. The best known adult day care system is provided by On Lok, a center in the Chinatown section of San Francisco. Lurie, *On Lok Senior Day Health Center: A Case Study*, GERONTOLOGIST, February 1976, at 16. Another experimental approach to providing noninstitutional long-term care is the community care organization, a channeling agency that assesses the needs of persons about to enter nursing homes and "brokers" services to fill those needs in the community to permit long-term care patients to remain at home. Community care organizations have been funded by HEW in Wisconsin and Colorado. New York is experimenting with home health care services under a federal grant. See N.Y. PUB. HEALTH CODE § 2382 (McKinney 1977).

mize bureaucratic apathy by changing the bureaucrats' jobs and/or by automating those jobs' inherently unchallenging aspects.⁷¹ Changing the focus of regulation sufficiently to provide a more creative job and to infuse new interest and energy into regulators would begin a new regulatory life cycle and at least renovate the process temporarily. One means of refocusing regulation would be to eliminate many of the extant licensing and certification standards that center only on regulatory structure and substitute standards that relate to the outcomes of care. For example, regulators could determine whether nursing home residents improve or maintain their health status over time rather than deteriorate and whether they meet objective or subjective norms and expectations.

Long-term care facility regulation since 1965 has been based, as noted above, upon the premise that nursing homes are merely extensions of hospitals, that residents primarily require medical treatment and that the only valid quality standards are those defining the structure of the facility. Considering that nursing home services are funded by Medicare and Medicaid, which pay for medical care, this emphasis is not surprising. But it has increasingly been recognized that although some nursing home residents do require fairly intensive nursing care while recuperating from acute illnesses or when suffering from terminal illnesses, such as those involving hospitalization, the vast majority of them have long-term chronic disabilities requiring some nursing care, but more importantly requiring aid in daily living activities, social services, organized activity programs and help in coping with the emotional and psychological problems of old age, debility and isolation. Thus, the so-called "medical hospital model" is inappropriate for most nursing home residents; yet the Medicaid-Medicare certification standards and most state licensing standards rely upon it.

Three approaches to establishing quality of care regulations for health facilities have been recognized since the advent of Medicaid and Medicare—structure, process and outcome measures.⁷² *Structural standards* measure facilities and equipment, numbers and qualifications of staff, administrative organization and operations, and fiscal systems. For instance, the Medicare-Medicaid Conditions of Participation include requirements that facilities have certain physical plant features

71. For an analysis of how job description and responsibility affect performance, see Herzberg, *One More Time: How Do You Motivate Employees?*, 46 HARV. BUS. REV. (1968).

72. Regan, *Quality Assurance Systems in Nursing Homes*, 53 U. DET. J. URB. L. 153, 160-61 (1975).

and also have policies regarding patients' rights, patient care, staff organization and services provided. The Conditions generally do not require examination of the content of the policies or whether they are implemented. Fewer than 20 of the 541 items on the Medicare-Medicaid survey inspection form⁷³ require an examination of the care given to patients or require surveyors to observe patients.⁷⁴ Most of the surveyors' time in the facility is spent reviewing documents, including staffing charts, menus, policies and procedures. This approach is based on the assumption that if the structure is appropriate, and the facility has the *capacity* to provide good care, good care will be provided.⁷⁵ The logic of this approach is specious, particularly when better and more appropriate standards exist to determine whether residents receive the care to which they are entitled.

Process standards measure the actual care delivered to patients and compare it to established norms of care throughout the area. For instance, surveyors using process standards would examine, on a sample basis, the completeness of information received about a patient through testing and diagnosis, the appropriateness of prescribed therapies to the diagnoses, and the technical competence of the performance of diagnostic and therapeutic procedures. Peer review processes, such as institutional utilization review in hospitals⁷⁶ and the Professional Standards Review Organizations (PSROs)⁷⁷ employ such a process approach, using standards developed by community norms of medical practice.⁷⁸ In long-term care, as contrasted with hospital care, however, process standards are more difficult to determine. Norms of care are relatively easy to establish for acute illnesses for which medical outcomes can be defined and evaluated. But treatment for chronic medical conditions, and especially for social problems, is far less easy to validate. Thus, while some process measures for the long-term care setting exist, many are still developmental, being demonstrated by, for example, PSRO long-term care projects.⁷⁹

73. Form No. SSA 1569. This and all medicare SNF forms are available from the state licensing agency and HEW offices.

74. OHIO REP., *supra* note 6, at 14-15.

75. See IMPROVEMENT STUDY, *supra* note 14, at 14-15.

76. See, e.g., 42 U.S.C. §§ 1395x(k), 1396a(a)(30) (1976); 42 C.F.R. §§ 456.50 -.145, 456.250 -.348 (1978).

77. 42 U.S.C. § 1320(c) (1976).

78. For an overview of PSRO and utilization review, see Price, Katz & Provence, *An Advocate's Guide to Utilization Review*, 11 CLEARINGHOUSE REV. 307 (1977).

79. Fifteen demonstration projects were funded wherein PSROs assessed quality of care in nursing homes under Medicaid and Medicare. Some of these projects, such as the one in

The final approach to regulating quality of care, *outcome standards*, focus on the outcome of care and determine whether patients achieve an expected recovery or stabilize rather than deteriorate. Outcome measures have been developed to test the effect of a few severe but chronic conditions such as stroke, heart attacks and hip replacement on activities of daily living,⁸⁰ but very few outcome measures exist for long-term care patients' conditions. Theoretically, in applying an outcome test to a patient, a regulator need not generally be concerned with the means used to achieve the desired outcome so long as the outcome is achieved.⁸¹ Under this theory of regulation, facilities would be given great flexibility to experiment with innovative forms of treatment and would be held accountable only for their results. An outcome approach to regulating quality of care requires considerably different regulating skills and inspection techniques. A question remains, however, whether outcome standards alone are sufficient. For example, safety and sanitation standards must remain in effect to protect patients from disaster or institutional infection. It is often asserted that required safety equipment such as sprinklers are very costly and unnecessary for buildings of modern construction.⁸² Certainly, many safety requirements, such as the door width standards in the Life Safety Code, seem minimally related to patient safety and might be eliminated as outcome standards become the primary basis for enforcement. But some fire safety standards should persist to protect residents in older buildings, where nursing home fires have occurred with fatal consequences.⁸³ Sanitation standards, to protect residents against food-borne or airborne contamination, are also necessary, and, unlike some safety regulations, should not be unduly costly to apply. In light of these considerations, outcome standards may be inappropriate for safety and sanitation regulation. Unlike most areas of patient care, in which patients are not put directly in jeopardy by a retrospective re-

Colorado, developed and tested certain process and outcome standards for long-term care residents of nursing homes.

80. Katz & Akpom, *A Measure of Primary Sociobiological Functions*, 6 INT'L J. HEALTH SERVICES 493 (1976); Katz & Akpom, *Index of ADL*, 14 (Supp.) MED. CARE 116 (1976).

81. There might, however, be legitimate reasons why a given individual did not achieve an expected norm. Therefore, the regulator would have to fall back upon process standards to evaluate the actual care provided to persons who failed to meet given outcome standards.

82. Feeley, Walsh & Fielding, *Structural Codes and Patient Safety: Does Strict Enforcement Make Sense*, 3 AM. J. L. & MED. 447, 453 (1976). The authors examine Massachusetts' experience with nursing home fires and conclude that sprinklers cost from \$86,000 to \$137,000 per potential year of life saved.

83. SUBCOMM. ON LONG-TERM CARE OF THE SENATE SPECIAL COMM. ON AGING, THE CONTINUING CHRONICLE OF NURSING HOME FIRES, *supra* note 32.

view on a frequent basis, applying fire safety, infection and sanitation standards on a retrospective basis would subject nursing home residents to an unacceptable risk.

Both process and outcome measures of quality of care require that facilities have the capacity to assess accurately the status of their residents, to determine the care required for a given discovered condition, to provide that care, and to evaluate continuously its effectiveness. A regulatory agency employing either of these measures must have the capacity to validate the facility's own assessment of the resident and either the outcome of care or the care provided. The agency must also have the capacity to collect, store and retrieve the information collected by facilities through their resident assessments and evaluate facility performance by applying quality of care standards that validly measure patient status. A certain amount of the routine work of the regulatory agency can thus be automated, freeing inspectors to perform actual resident assessment and draw conclusions about facility quality performance.

Considerable work has been done through government and private research over the last decade on systems of patient assessment in long-term care. One of the best known patient assessment systems is "PACE," the Patient Assessment and Care Evaluation system developed by the Office of Nursing Home Affairs in HEW from 1974 to 1978.⁸⁴ Drawing upon the work of Densen, Katz and Jones at the Harvard Center for Community Health, the PACE system provides an instrument by which nursing home staff can assess an individual's functional level and determine medical, nursing and social needs. The "Care Evaluation" component of the system requires the facility staff to develop a plan of care to meet the assessed needs and to evaluate the effectiveness of the care by periodic reassessment.⁸⁵ The use of such a system of patient assessment can provide the opportunity for regulators to look at the actual care delivered to patients rather than merely at a facility's theoretical capacity to provide the care. In fact, it was the recognition of this critical flaw in the extant nursing home quality of care enforcement system that led the Office of Nursing Home Affairs to

84. See, e.g., DEP'T HEW, *THE PACE PROGRAM FOR LONG-TERM CARE* (1978).

85. Numerous other systems have been developed. Since they derive primarily from the same base, however, they are quite similar. See, e.g., COLORADO DEP'T OF HEALTH, *VITAL STATISTICS DIVISION, LONG-TERM CARE PATIENT EVALUATION ABSTRACT* (1975); DUKE UNIV. CENTER FOR THE STUDY OF AGING AND HUMAN DEVELOPMENT, *MULTIDIMENSIONAL FUNCTIONAL ASSESSMENTS: THE OARS METHODOLOGY* (1975).

develop PACE.⁸⁶ This system can also form the basis for reimbursing facilities according to resident outcomes.⁸⁷

A prerequisite to an outcome-oriented system is the definition of the expected changes in patient status that should occur at various points in time if appropriate health care is provided. Similarly, the structure and process standards that are currently being employed should be sufficiently well-defined and should avoid the open-ended and imprecise terms currently contained in the Conditions of Participation. While it is appropriate that state agencies or HEW have the discretion to establish standards, that discretion should be exercised to circumscribe the discretion of individual surveyors by avoiding the use of such vague and subjective terms as "adequate," "qualified" and "sufficient" that fill the current federal standards⁸⁸ but are difficult to enforce.⁸⁹ Neither facilities nor surveyors can be completely sure of their meaning. It is difficult to prosecute enforcement actions with vague standards; administrative bodies and courts are not comfortable with state agency application of ill-defined standards that leave great discretion to surveyors, and surveyors themselves prefer specific standards that they can apply with confidence. On the other hand, imposition of highly specific and detailed standards leads to the charge of bureaucratic nitpicking, harassment and undue government interference with facility management.⁹⁰ Although detailed standards are easier to enforce and, by minimizing the exercise of surveyor judgment, assure uniform and objective enforcement in agencies with several surveyors,⁹¹ establishing management, personnel and patient care policies may stifle facility innovation and creativity.⁹²

Because current federal and state standards (most of which are patterned after the federal Conditions) do not focus on whether the needs of individual residents are being fulfilled, they do not assure

86. See generally IMPROVEMENT STUDY, *supra* note 14.

87. See notes 133-40 and accompanying text *infra*.

88. See, e.g., 42 C.F.R. §§ 405.1124, .1125(a), .1126, .1126(a), .1130, .1130(b), .1131(a)-(b), .1135(c) (1977).

89. NAAG REP., *supra* note 64, at 34; see *Levine v. Whalen*, 39 N.Y.2d 510, 349 N.E.2d 820, 384 N.Y.S.2d 721 (1976).

90. See *Brown, An Appraisal of the Nursing Home Enforcement Process*, 17 ARIZ. L. REV. 304, 316 (1975).

91. Nursing homes in Colorado frequently allege that different surveyors are inconsistent in finding deficiencies in the same facilities. This often justified criticism results from the broad discretion left to each surveyor by state and federal standards.

92. The debate over the extent of detail in which the government should set standards will never be fully resolved, but decisions will have to be made as HEW issues new conditions of participation in 1979.

quality of resident care. The solution to this problem is resident-focused standards, such as outcome standards, but few currently exist. New measures of quality of nursing home care and new enforcement techniques for surveyors to use in applying them must be developed.⁹³ Changing the standards to a resident orientation and enhancing survey capacity with different professional skills, such as resident assessment, could kindle a new spirit of dedication and energy in a regulatory agency staff that could lead, at least for a time, to improved enforcement activity and begin another regulatory life-cycle.⁹⁴

C. *Economic Incentives for the Provision of Quality Care*

Because most nursing homes are proprietary, most nursing home owners are motivated primarily by a concern for maximization of profits rather than residents' welfare. It would thus seem possible to improve the quality of nursing home care through economic incentives, such as rewards for good care or financial penalties for poor care, encouraging competition within regulatory guidelines. It must, of course, be recognized that while adequate reimbursement is a prerequisite to quality care, and while reimbursement can be designed to furnish incentives for facilities to provide good care, it cannot guarantee that the care will be provided,⁹⁵ just as establishing structural standards that examine a facility's theoretical capacity to provide quality care does not ensure its actual delivery. Thus, even if reimbursement is high enough to cover the actual costs of quality care, a means to examine the process or outcome of care must be tied to reimbursement to assure that care is appropriately delivered.

Before discussing reimbursement policies, however, it is necessary to highlight briefly the primary characteristics of nursing home financing and economic behavior and then to examine alternative means of reimbursement and their effect on facility conduct regarding resident care.

1. Nursing Home Financing

The nursing home industry, most of which is proprietary,⁹⁶ is capi-

93. See IMPROVEMENT STUDY, *supra* note 14, at 14-15.

94. See notes 52-60 *supra*.

95. OHIO REP., *supra* note 6, at 9.

96. The nursing home industry grew from 7000 nursing care homes in 1954 to 9500 in 1960, 12,000 in 1965, F. MOSS & V. HALAMANDARIS, *supra* note 2, at 7, and 18,000 in 1976. NATIONAL CENTER FOR HEALTH STATISTICS, MASTER FACILITY INVENTORY 15 (1976). At present, 93% are privately owned and 75% of those are proprietary. Kane & Kane, *supra* note 29, at 814 (Table 2).

tal-intensive, generating lower annual revenues than would otherwise be generated by the capital used by the industry.⁹⁷ Profit from the nursing home industry as a whole is generally lower than that in other businesses—about four percent in 1976.⁹⁸ The industry, however, is attractive to investors not because of its profits, but because of its potential for cash flow. Because the primary capital investment in the nursing home business is real estate, and because Medicaid and Medicare generously reimburse depreciation (a non-cash flow item), if amortization of debt-financed principal is less than depreciation expense, nursing homes generate cash flow at the rate of about thirty cents per dollar invested.⁹⁹

Because a higher net cash flow, the principal factor in the attraction of capital to the nursing home industry, is based primarily on larger depreciation deductions, it is clear that nursing home owners will seek to maximize their depreciable basis (by transferring a facility to increase its tax basis) and to maintain revenue sufficient to cover mortgage payments in order to assure a tax-sheltered cash flow by either maximizing income or minimizing expenses. An owner can maximize income by attempting to increase Medicaid and private pay rates (although the owner may have little actual control over them) and by maintaining high occupancy rates in his facilities. The owner, however, has far more control over operating expenses, such as those for labor, food and patient care services. Because these costs directly or indirectly affect patient care in nursing homes, the means of nursing home financing of and reimbursement for these items have obvious implications for quality of care.¹⁰⁰

By comparison, of the 6500 hospitals in the United States, only 13% are proprietary. *Id.* Since 1967, the nursing home industry has been "big business"; many facilities are owned by national chains and are publicly traded on the major stock exchanges. Shulman & Galanter, *Reorganizing the Nursing Home Industry: A Proposal*, 10 MILBANK MEM. FUND Q. 129 (1976). Although cut-backs in Medicare reimbursement in 1967-68 caused a sharp decline in proprietary nursing home profits, Butler, *An Advocate's Guide to the Medicare Program*, 8 CLEARINGHOUSE REV. 831, 837 (1975), the industry continues to enjoy a substantial profit margin and is an attractive investment. F. MOSS & V. HALAMANDARIS, *supra* note 2, at 73-101. One hundred proprietary chains control one-fifth of the nursing home beds in the United States; the largest of these operates 121 facilities with over 20,000 beds and had gross revenue in 1976 exceeding \$97 million. *See* Dole, *An Investigation into the Business of Caring for the Elderly*, 23 NURSING HOMES 2 (1979).

97. Shulman & Galanter, *supra* note 96, at 134 (1976). *See also* F. MOSS & V. HALAMANDARIS, *supra* note 2, at 73-85.

98. Shulman & Galanter, *supra* note 96, at 135.

99. *Id.* at 134-37.

100. *Id.* at 137-38. The authors propose government ownership of nursing home real estate and private management contracts for providing patient care services as one means of shifting incentives for profit maximization away from diverting resources to cover capital and toward applying resources to patient care costs. They suggest that management contracts could be

While some commentators attribute nursing home quality of care problems to the profit-making status of the facilities and suggest that a solution is to mandate that nursing homes be only not-for-profit entities, evidence generally shows that nonprofit homes do not provide a higher quality of care than proprietary facilities.¹⁰¹ Moreover, the principals in a nonprofit corporation may obtain significant compensation by providing goods and services (often at inflated rates) to the corporation, by selling or leasing, and, of course, by the same fraudulent practices engaged in by some owners of profit-making entities. Since nonprofit nursing homes are exempt from property and other local taxes, they can be highly "profitable" enterprises. Although state taxing authorities are empowered to disqualify nonprofit corporations that actually generate profits, neither they nor state licensing agencies set standards for accounting, purchasing, compensation or investment practices of nursing homes.¹⁰² There is thus no means of assuring that nonprofit facilities return income to patient care services instead of to the pockets of principals, who are essentially their owners. Those nonprofit nursing homes that provide a high quality of care to their residents do so because of the dedication, commitment and beneficent motivations of their managers and employees. The absence of a need to generate profits for owners may certainly support these motivations, but it in no way guarantees their existence.

2. Reimbursement Approaches Under Medicaid and Medicare¹⁰³

Before the 1972 Social Security amendments provision requiring Medicaid to reimburse SNFs and ICFs on a "reasonable-cost-related basis,"¹⁰⁴ states used a variety of methods for nursing home reimburse-

negotiated periodically on a competitive bid basis. The authors argue that such a system would provide greater control over quality by providing time-limited, non-vested agreements, public accountability for contract performance, and competitor scrutiny of cost and quality. *Id.* at 139-42.

101. See M. MENDELSON, *TENDER LOVING GREED* 195-212 (1974). See also ACTION COALITION OF ELDERS, *KANE HOSPITAL: A PLACE TO DIE* (1975). Experience in California with prepaid health plans (organized providers of health care who contracted with the state Medicaid agency to serve Medicaid beneficiaries) demonstrated that not-for-profit entities actually generate profits that were hidden through deceptive or fraudulent accounting practices and provided a generally poor quality of health care service. S. REP. NO. 95-749, 95th Cong., 2d Sess. 9-12 (1978).

102. Federal regulations on Medicaid nursing home reimbursement, however, now prohibit costs of services furnished to "related organizations" exceeding the market price of the services. 43 Fed. Reg. 45,259 (1978) (to be codified in 42 C.F.R. § 447.284 (a)).

103. For an extensive overview of nursing home reimbursement, see Coleman & Schneider, *An Advocate's Guide to Nursing Home Reimbursement* (1979) (available from the National Health Law Program, 2401 Main Street, Santa Monica, Calif. 90405).

104. Social Security Amendments of 1972, Pub. L. No. 92-603, § 246, 86 Stat. 1426 (1972) (codified at 42 U.S.C. § 1396a(a)(13)(E) (1976)).

ment. Some paid on a flat rate, usually differentiating between SNFs and ICFs. Others paid on a cost-plus basis, paying all costs plus a factor for profit; among the latter reimbursement systems were variations including cost reimbursement up to a ceiling and costs up to a ceiling plus a profit factor. Medicare reimburses nursing homes on the basis of "reasonable cost,"¹⁰⁵ which amounts to full payment for most facility costs, without a ceiling, plus a profit factor computed as a reasonable return on net invested equity, currently set at 10.5 percent.¹⁰⁶

Different reimbursement mechanisms provide incentives for different economic behavior, produce different regulatory atmospheres, and can advance different social goals. Flat rates, for instance, create incentives for facilities to reduce variable costs (which will likely be those costs attributable to patient care) in order to maximize profits; such a system does tend to hold down costs of care as well as the expenses of administration and produces more budget predictability for the paying agency. It may produce poor quality care, however, and to the extent that the rate is seen as unduly low, facilities will discriminate against publicly financed patients.¹⁰⁷

A cost-plus reimbursement system under which states pay "allowable costs" is inherently inflationary and contains no incentives for efficiency, although it also provides no disincentives for quality care as long as states cover all patient care costs. It is more expensive to administer, since cost reports must be audited. Some facilities have inflated their allowable costs by sale and leaseback arrangements, excessive interest payments, inflated initial costs, and refinancing to minimize their own invested equity and maximize the rate of return.¹⁰⁸ Furthermore, determination of what costs are allowable is politically sensitive and difficult. To curb the inflationary impact of cost reimbursement, some states have imposed ceilings beyond which they will not reimburse. Under this approach, high cost institutions whose costs exceed the ceiling will behave as if they were reimbursed on a flat rate; for lower cost homes the system resembles cost reimbursement and provides an incentive for them to increase costs over time up to the ceiling.

105. 42 U.S.C. §§ 1395(f), (p) (1976).

106. *Id.* § 1395(x)(v)(1)(B) (1976); 42 C.F.R. § 405.429 (1978); [1977] 1 MEDICARE & MEDICAID GUIDE (CCH) ¶ 5782.

107. Minnesota law prohibits nursing homes from charging private patients over 10% more than Medicaid patients. MINN. STAT. ANN. § 256B.48 (West Cum. Supp. 1979). This statute is being challenged by the industry in *Minnesota Ass'n of Health Care Facilities v. Perpich*, No. 377-CN-467 (D. Minn., filed Oct. 15, 1977).

108. See F. MOSS & V. HALAMANDARIS, *supra* note 2, at 90-100, for a discussion of some common means of profiteering.

The costs of administration and audit are similar to those under a cost system, but the state is protected from unchecked strains on its budget. The placement of the ceiling in this method is critical to determining whether patient care suffers. If the ceiling merely penalizes inefficient homes it might not adversely affect patient care; however, a ceiling placed too low may jeopardize care to patients.

States may also pay costs up to a ceiling plus an additional profit factor beyond the ceiling, calculated as a return on the owner's net invested equity.¹⁰⁹ Payment of profit based on net invested equity (the Medicare method) is viewed as a means of encouraging more personal investment in a facility (as opposed to using borrowed funds for capital) on the theory that if one has invested his own money in a business he will be more likely to safeguard its reputation and provide a higher quality of care for patients. While this method may thus provide a greater incentive than the other two cost-plus mechanisms, it does not relate profit directly to a facility's quality of care, but rather assumes that quality will accompany return on an owner's personal investment, an assumption of very questionable validity.

Federal Medicaid regulations issued to implement the new cost-related nursing home reimbursement requirement of the 1972 Social Security amendments¹¹⁰ indicate that flat rates (which would not be cost-related) and cost reimbursement without a ceiling are not acceptable.¹¹¹ Furthermore, states are not required to provide a profit.¹¹² In no event may rates exceed those paid under Medicare,¹¹³ but they must be high enough to cover "actual allowable costs of a facility that is economically and efficiently operated,"¹¹⁴ including the costs of meeting state licensing and federal certification requirements¹¹⁵ and of routine services (room and board, nursing care, medical supplies and equipment).¹¹⁶ The regulations permit states to provide incentives to participating facilities to upgrade the quality of care through reimbursement.¹¹⁷

109. 43 Fed. Reg. 4862 (1978).

110. 42 C.F.R. § 447.272-316 (1978).

111. 43 Fed. Reg. 4863 (1978).

112. *Id.* 4862-63.

113. 42 C.F.R. § 447.316. (1978). Rates set prospectively may be effectively higher than Medicare rates. *Id.* § 447.306(b).

114. *Id.* § 447.302(b); *see Alabama Nursing Home Ass'n v. Califano*, 465 F. Supp. 605 (M.D. Ala. 1979).

115. *Id.* § 447.279.

116. *Id.* § 447.281.

117. *Id.* § 447-306.

Traditionally, under Medicaid and Medicare, health care institutions that are paid on a cost basis, which includes hospitals under both programs as well as Medicare nursing homes, are periodically reimbursed at an estimated rate during the accounting period (usually a fiscal year), after which the facilities account for their allowable costs and the paying agency adjusts the rate upward or downward. Such a retrospective system is inflationary. To curb health care cost inflation, the federal government under Medicare and the state Medicaid agencies are experimenting with prospective reimbursement, in which rates are set in advance and no adjustment is made to reflect actual costs incurred.¹¹⁸ While this approach permits states to budget accurately and may save the administrative cost of auditing facilities, it has the serious disadvantage of promoting discrimination against publicly financed patients if a facility feels that its rate does not reflect true cost.

3. Reimbursement as a Quality Assurance Device

Several mechanisms have been proposed or are being used to employ the leverage of Medicaid reimbursement as a means of regulating quality of care for publicly supported residents.¹¹⁹ Some, such as the system used in Illinois, are based on process measures, but most are based on the structural standards of the federal Conditions of Participation. A necessary prerequisite to any such quality enforcement system is, of course, established standards that can form the basis for reimbursement.

The state of Michigan, which had paid nursing homes on a flat rate and then on the basis of costs up to a ceiling, adopted a penalty system related to reimbursement after two studies showed that the state's nursing homes averaged a forty percent return on net invested equity,¹²⁰ four times the Medicare allowable rate and over three times the "normal" rate accepted in the investment community. The Michigan system now pays costs plus a \$1.25 per patient per day profit factor up to a ceiling. If a facility fails to comply with any of the eighteen Medicaid-Medicare Conditions of Participation, the facility's profit factor is reduced according to a point system with the maximum reduction being one dollar per patient per day. The system has several flaws. Because the penalty comes from profit rather than variable costs, pre-

118. These are the demonstration projects authorized under the Social Security Amendments of 1972, Pub. L. No. 92-603, § 222(a), 86 Stat. 1390 (1972).

119. See note 141 *infra*.

120. See generally Coleman & Schneider, *supra* note 103.

sumably patient care does not suffer. But because the penalty comes from profit that is only available under the system to facilities whose costs fall below the ceiling, a facility can avoid being penalized by becoming inefficient, that is, raising costs above the ceiling.¹²¹ Whether the penalty really comes from profit depends upon the accuracy and detail of the audits that safeguard against owners and operators withdrawing funds from patient care sources. Another problem with the system is its dependence upon the federal Conditions of Participation as indicators of quality of care. As discussed above, most of the Conditions merely examine the capability of the facility to provide care rather than the care actually provided. Tying penalties to the Conditions, rather than to their component standards or elements, also raises the problem that there may be serious violations of some standards that do not, in the surveyors' judgment, amount to violations of the entire Condition, and hence will not trigger application of the penalty. In addition, enforcement personnel may be reluctant to find noncompliance with Conditions knowing that financial penalties will attach.¹²² Another potential problem with this approach is that if providers assert the right to contest the surveyors' judgments regarding compliance with standards, the entire reimbursement system can become mired in lengthy administrative and judicial proceedings.

The state of Illinois adopted a different approach, paying three types of costs: capital costs up to a maximum, nursing costs at a flat rate, and support (administrative, dietary and maintenance) costs at the level of the fiftieth percentile of all homes in various geographic regions. Homes falling below the fiftieth percentile of support costs could keep half of the difference as an incentive profit; those above the fiftieth percentile received none.¹²³ In addition, the state would pay nursing homes according to a "point count system." Patients were assessed, and, based on their conditions, the state determined the types of nursing care or rehabilitative services that should be provided. Homes were then paid according to the "point" assigned to each of these services and the state would survey to determine whether the services were actually rendered. While this system does encourage facilities to accept and treat higher risk patients with greater needs, it creates the perverse incentive for facilities to maintain patients at their sickest in order to

121. *See id.*

122. This behavior has been noted in other penalty systems. *See* notes 223-24 and accompanying text *infra*.

123. ILL. DEP'T OF PUBLIC AID RULES §§ 4.142, .144(d) (1977).

maximize profits, and creates no incentive for facilities to rehabilitate or assist patients in achieving their maximum potential for independence or self-care. It also raises the question of what services in a nursing home should be routinely available to everyone in the facility and what services are really "extra."¹²⁴

The Massachusetts Rate Commission proposed another quality-related nursing home reimbursement scheme that would pay a thirty cent per patient per day bonus for facilities achieving a high quality score. To receive the bonus a facility must have a composite score of ninety-five or more on the 541 items found on the federal SNF survey form, be above average on the nursing, medical and social services components of the state's Medical Review program, have no pending enforcement actions against it, be within the range of normal nursing and variable cost screens, and be above average in Medicaid patient census levels.¹²⁵ While such a system would overcome the incentive for facilities to keep patients disabled and debilitated, as in the Illinois scheme, it still relies on the federal Conditions of Participation as its quality indicators and on the validity and reliability of the actual weighting of the 541 quality indicators.¹²⁶

New York has also developed a reimbursement system tied to quality of care. Facilities are grouped according to bed size, geographic location and whether they are SNFs or ICFs. Facilities are rated according to their scores on state licensing standards for nursing service, dietary service, housekeeping service, social work, and activities, and according to their scores on the medical review of resident conditions by state officials.¹²⁷ Based on these scores, the state ranks facilities as "very good," "satisfactory" or "needs improvement."¹²⁸ Costs of each of the five services noted above plus administrative costs are averaged for each of the three categories. The state computes a ceiling for the "satisfactory" category at the group's weighted average, and computes ceilings for "very good" and "needs improvement" at

124. The State of Utah proposed a similar system to provide incentive reimbursement according to nursing home patients' needs. The system was apparently approved by HEW but never implemented. See *Utah Long-Term Care Payments System* (Feb. 1976) (available from Bruce Walter, Utah State Division of Health, Medical Care & Facilities Branch, Salt Lake City, Utah 84110).

125. 114.2 CODE OF MASS. REGULATIONS § 2.16 (1977).

126. The weights were assigned by subjective judgments of a group of surveyors. The state's own estimates were that over one-fourth of facilities qualifying for the incentive would not actually deserve it. See CONSUMER HEALTH ADVOCACY PROGRAM OF MASSACHUSETTS, MEMORANDUM FOR THE RATE SETTING COMMISSION 4-8 (1978).

127. See N.Y. DEP'T. OF HEALTH, HOSPITAL MEMORANDUM NO. 76-57 (1976).

128. *Id.*

110 percent and 90 percent of the "satisfactory" cost ceiling or at the group's average, whichever is higher.¹²⁹ In addition to paying for capital costs, depreciation, interest expense and return on net invested equity,¹³⁰ the state reimburses each facility at the rate of the lower of its actual costs for the six items mentioned above or the ceilings on costs attributable to the facility's rating category.

Since the ceiling on reimbursement for any facility is the lower of its actual cost or the group's actual cost, it is questionable whether this system provides a meaningful incentive to achieve a "very good" score. An advantage to the system, however, is that the New York quality indicators are more precise and certainly more patient-focused than the federal Conditions of Participation.¹³¹ It has been observed, however, that the rating system is so strict that, of 550 nursing homes in the state, only 4 or 5 qualify as "very good," and the value of the "incentive" system is greatly diminished.¹³²

A reimbursement approach could create more appropriate incentives for facilities to improve patient care, rather than to maintain patient dependence, if it were based upon the outcome of care rather than the care process.¹³³ No states have yet developed such a system, although research directed to this end is under way.¹³⁴ Nor has HEW met its primary responsibility for quality enforcement by developing such a reimbursement scheme. An obstacle to the implementation of an outcome reimbursement system is the lack of clearly defined and statistically valid outcome measures for long-term care that would allow judgment of facility performance¹³⁵ and reimbursement through a bonus for patients achieving expected outcomes or a penalty for patients failing to achieve them. The scheme would depend upon a system of patient assessment performed regularly by facilities and audited

129. 10 N.Y. CODE OF RULES AND REGULATIONS § 86-2.11 (1978).

130. *Id.* § 86-2.19-28.

131. New York regulations also permit facilities to seek exemption from these rates for aberrations in services, patient mix, and lengths of stay by state departmental "management assessment reviews." *Id.* § 86-2.14(a)(17). The rules also permit the state to penalize facilities for poor quality of care. *Id.* § 86-2.14(f).

132. Interview with Phil Gassel, Legal Services for the Elderly Poor, 1095 Broadway, New York, N.Y. (Dec. 17, 1978).

133. For a proposal to develop such a system, see Ruchlin, Levey & Muller, *The Long-Term Care Marketplace: An Analysis of Deficiencies and Potential Reform by Means of Incentive Reimbursement*, 13 MED. CARE 979 (1975).

134. See, e.g., CENTER FOR HEALTH SERVICES RESEARCH, UNIV. OF COLORADO MED. CENTER, *LONG-TERM CARE REIMBURSEMENT AND REGULATION: A STUDY OF COST, CASE MIX AND QUALITY* (1978) (continuing study funded by the Health Care Financing Administration, HEW, in December 1978 for a three-year period).

135. See note 80 and accompanying text *supra*.

by the state agency. As noted above,¹³⁶ the technology for this assessment exists and could be rapidly put into place.¹³⁷ Patients would be grouped according to their conditions or status, and their progress, maintenance or regress would be measured according to key health status indicators. The average progress, maintenance or regress of each group at each assessment would be summed to create a facility health status profile that could be compared to an absolute standard (when one could be developed) or to the relative performance of other facilities.

Such an assessment and reimbursement system could reveal the ability of a facility to provide the types of services that its residents need to improve or maintain their health. It requires a sophisticated model to be developed, including the choice of key health status indicators, the weight to be accorded each one, the size and nature of patient groupings, and the choice of an equitable bonus or penalty mechanism. Because the system could be abused through fraud, the state agency would have to establish a thorough and sensitive monitoring system to assure accurate information about patient status. The system would create an incentive for selection of only easily remediable patients unless it prohibits that discrimination and/or includes as an acceptable outcome an individual's *maintenance* of status in addition to *improvement* in status. Furthermore, it must accommodate patients who will not achieve expected outcomes despite the best and most dedicated efforts of facility staff; this safeguard could occur through the averaging process or a more complicated system that would examine inputs of care for those persons not achieving expected outcomes and not penalize the facility if it had provided appropriate care.¹³⁸

While it would be more complex than the current regulatory program, an outcome reimbursement system could eliminate many of the present structural standards that are irrelevant to patient care.¹³⁹ In addition, the system appears to create the most appropriate incentives for a facility to provide high quality care—at least care designed to improve or maintain resident status. In view of the complexities of developing and implementing such a system, it is not an immediately attainable goal; it is, however, one toward which HEW and state

136. See notes 84-87 and accompanying text *supra*.

137. See Memorandum to Massachusetts Rate Setting Commission from Paul Denson and Ellen Jones, Harvard Center for Community Health and Medical Care (December 12, 1978).

138. See note 81 and accompanying text *supra*.

139. See notes 80-83 and accompanying text *supra*.

Medicaid agencies should strive (by, for instance, implementing mandatory resident assessment by all facilities) while developing other reimbursement systems to use the competitive behavior of proprietary facilities to provide incentives for high quality of care.¹⁴⁰

D. Improving Enforcement Mechanisms

1. Practical Enforcement Problems

Were patient-focused standards properly designed and outcome reimbursement in place today, regulators might not need additional enforcement remedies to ensure provision of high quality care to publicly supported residents of nursing homes.¹⁴¹ Until those programs are developed, however, state agencies will need a broad array of enforcement remedies, tailored to the seriousness of violations, with which to enforce quality standards. Prior to the recent enactment of legislation to permit enforcement mechanisms in some states, the only remedies for violations of state licensing or Medicaid certification standards were license revocation, refusal to renew the annual Medicaid contract,¹⁴² or decertification during the contract term. Such exclusive remedies are difficult to enforce because facilities demand lengthy administrative hearings and because closing a facility and moving its residents can often have serious consequences.

Licenses are viewed legally as property that cannot be revoked without due process—usually timely and adequate notice and a full hearing on the charges before revocation.¹⁴³ Courts also view ongoing Medicaid participation during the annual contract term as a property right subject to the same procedural protections.¹⁴⁴ It might appear that a state's refusal to renew a Medicaid contract (as opposed to termination of the contract during the period) involves no property right, since the facility has no right to expect a renewal of its Medicaid participation agreement. Some courts have analyzed the contract situation in

140. See, e.g., Shulman & Galanter, *supra* note 96.

141. Privately supported residents (about 38% of all nursing home residents) would be aided directly by resident-oriented state licensing standards and indirectly by Medicaid quality-oriented reimbursement policies, which should improve overall facility care. Arguably, even with improved reimbursement policies, some of the state enforcement remedies discussed in notes 142-289 and accompanying text *infra* would be necessary to protect non-publicly supported nursing home residents.

142. Under certain circumstances, agencies can execute short-term contracts with Medicaid and Medicare nursing homes, but this authority is limited. See notes 39-40 *supra*.

143. See COLO. REV. STAT. § 24-4-104 (Cum. Supp. 1978)

144. See, e.g., Shady Acres Nursing Home, Inc. v. Canary, 39 Ohio App. 2d 47, 316 N.E.2d 481 (1973).

this manner, holding that no pretermination hearing is constitutionally required.¹⁴¹ The Second and Seventh Circuits, however, have tended to find a property right in the "expectancy interest" of a facility that its contract would be renewed and have required notice and hearing *before* a state may refuse to renew a Medicaid participation agreement.¹⁴² Pending that hearing, these courts have ordered state agencies to continue to pay the facilities for their Medicaid residents regardless of the availability of federal funds for those patients.¹⁴³

The Second Circuit, in *Case v. Weinberger*,¹⁴⁴ followed the Supreme Court's direction in *Weinberger v. Salf*¹⁴⁵ in determining the type of hearing that must be provided to the facility to satisfy due process. The court of appeals balanced the government's interest in the health and safety of the nursing home patients against the facility's need for some type of adequate review mechanism in regard to reimbursement and determined that the informal discussions between the facility owner and the government authorities, combined with the opportunity of a full-scale post-contract evidentiary hearing, provided due process protection against arbitrary government action.¹⁴⁶ The court also acknowledged the legitimacy of a state agency's summary revocation or refusal to renew a contract in emergencies that seriously threaten patient safety, and noted that a later hearing would satisfy due process under those circumstances.¹⁴⁷ Thus, both the court's holding and its *dictum* render a desirable result.

Facilities sometimes invoke the rights of their patients not to be moved without a hearing,¹⁴⁸ a legitimate concern if the state Medicaid

141. *See, e.g.*, *Paramount Convalescent Center, Inc. v. Department of Health Care Services*, 13 Cal. 3d 488, 542 P.2d 1, 123 Cal. Rptr. 2d3 (1975); *Convalescent Care Center, Inc. v. Bates*, 44 U.S.L.W. 3574 (Franklin County Ct. App., May 15, 1975), *cert. denied*, 425 U.S. 952 (1975); *Shady Acres Nursing Home, Inc. v. Canale*, 24 Ohio App. 2d 47, 315 N.E.2d 419 (1975).

142. In *Case v. Weinberger*, 523 F.2d 602 (2d Cir. 1975), and *Hathaway v. Matthews*, 541 F.2d 227 (7th Cir. 1976), the courts found a property right in the expectancy interest of renewal of the Medicaid provider agreement. Despite the language of these holdings, however, it is unclear from the facts of those cases whether they did indeed involve a refusal to renew or a decision to terminate a Medicaid contract during its term. In *Case* the Court of Appeals for the Second Circuit said that HEW determined that the facility would "no longer be certified" as a Medicaid provider. 523 F.2d at 605. In *Hathaway*, the Court of Appeals for the Seventh Circuit indicated that the home renewed a one-year Medicaid contract in December, 1975 and was notified in March 1976 that payment would be terminated for violations of state licensing standards. 541 F.2d at 228.

143. *See, e.g.*, *Hathaway v. Matthews*, 541 F.2d 227, 232 (1976).

144. 523 F.2d 602 (2d Cir. 1975).

145. 422 U.S. 749 (1975).

146. 523 F.2d at 607-11. *See also* *Schwartzberg v. California*, 453 F. Supp. 1142 (S.D.N.Y. 1978).

147. 523 F.2d at 608.

148. *See, e.g.*, *Schwartzberg v. California*, 453 F. Supp. 1142, 1146 (S.D.N.Y. 1978).

agency is threatening to terminate a Medicaid beneficiary's eligibility for services on the ground that the services are not medically necessary.¹⁵³ But when the facility is subject to closure for failure to meet licensing or certification standards, one must be suspicious of a facility's motives when it invokes the threat to patient safety from transfers out of the closed facility. While the danger of transfer trauma is quite real,¹⁵⁴ and a period of time for "transfer planning" must be afforded to residents in all but emergency cases, one must carefully weigh the relative harm from transfer against that of remaining in an unsafe institution, recognizing that many violations of standards do not actually jeopardize patient safety. These lines are difficult to draw, but some courts have grappled with them.¹⁵⁵ Even the actual presence of beneficiaries as intervenors in cases in which facilities challenge government revocation of licensure or certification¹⁵⁶ does not assure that nursing home residents' interests are completely protected, because neither the residents themselves nor their representatives can fully appreciate what is in their best interest when faced with the untenable choice between moving or remaining in a substandard facility that threatens their lives.¹⁵⁷

States face a peculiar dilemma in all certification cases. Federal law prohibits the continuation of federal funds under Medicaid for more than thirty days after a decision to revoke a certification.¹⁵⁸ Thus, the state itself may be required to pay for care in a facility for an indefinite period of time pending legal proceedings, even if the facility poses a serious threat to patient life or safety.¹⁵⁹ This substantial state expense in time and money, coupled with the severe dilemma posed by

153. All suits by Medicaid beneficiaries challenging the termination of medical eligibility without prior hearings when termination resulted in transfers out of nursing facilities have been successful. *See, e.g.,* Feld v. Berger, 424 F. Supp. 1356 (S.D.N.Y. 1976).

154. *See* notes 164-66 and accompanying text *infra*.

155. *See, e.g.,* Schwartzberg v. Califano, 453 F. Supp. 1042 (S.D.N.Y. 1978).

156. *See, e.g.,* Caton Ridge Nursing Home, Inc. v. Califano, 447 F. Supp. 1222 (D. Md. 1978); Klein v. Mathews, 430 F. Supp. 1005 (D.N.J. 1977), *aff'd sub nom.* Klein v. Califano, 586 F.2d 250 (3d Cir. 1978); Kane v. Perry, 82 Misc. 2d 1019, 371 N.Y.S. 2d 605 (Sup. Ct. 1975), *rev'd*, 55 App. Div. 2d 678, 390 N.Y.S. 2d 191 (1976).

157. *See* note 164 *infra*.

158. 43 Fed. Reg. 45,234 (1978) (to be codified in 42 C.F.R. § 442.15(c)). Such a deprivation seems unconstitutional, but the Supreme Court has held that states have no due process rights because they are not "persons" within the meaning of the fifth amendment. *South Carolina v. Katzenbach*, 383 U.S. 301 (1966). States may contest HEW's refusal to reimburse costs of nursing home services in a decertified home, under 42 U.S.C. § 1316 (1976). *See* Klein v. Mathews, 430 F. Supp. 1005, 1006 n.2, 1008 n.8 (D.N.J. 1977). Furthermore, facilities such as Town Court Nursing Home masquerade as resident representatives. *Town Court Nursing Center, Inc. v. Beal*, 586 F. 2d 280 (3d Cir.), *cert. granted*, 47 U.S.L.W. 3683 (1979).

159. *See* OHIO REP., *supra* note 6, at 26-27.

the inhumane position of leaving patients in a facility that actually threatens their lives or health and the potential danger of moving them, immobilizes agencies and deters invocation of decertification or license revocation except in extreme circumstances.

In a license or certification revocation situation a pretermination hearing is clearly required by the Constitution and most state laws, unless there is an immediate threat to patient health and safety, in which case summary revocation is usually permissible.¹⁶⁰ These license revocation proceedings, however, are costly and time consuming.¹⁶¹ Furthermore, license revocation and Medicaid decertification is a drastic step that, if successful, eventually results in the closing of the facility and the moving of its residents. Other than acting as a possible deterrent to other facilities violating the law, it is not a means of improving the quality of life or health in institutions. Moving residents causes at least three serious problems. First, in communities without alternative beds, residents may be moved far from families and friends.¹⁶² Since visits by relatives and friends not only are desired by nursing home residents, but are arguably a quality enforcement tool,¹⁶³ they should be encouraged rather than discouraged. Second, closing a facility may also pose a problem in urban areas where there is an insufficient number of nursing home beds to accept residents moving from a closed home. Finally, resident relocation may cause the phenomenon known as "transfer shock" or "transfer trauma."¹⁶⁴ Many nursing home resi-

160. See, e.g., COLO. REV. STAT. § 24-4-104 (Cum. Supp. 1978). But see *Ross v. Wisconsin Dep't of Health & Social Services*, 369 F. Supp. 570 (E.D. Wis. 1973) (invalidating a state statute permitting emergency moving of patients from facilities that violated state health and safety standards).

161. For example, the attempt to revoke the license and Medicaid certification of a nursing home in Colorado involved an administrative hearing of 20 days, 4000 pages of testimony and exhibits, over \$10,000 in legal expenses, and more than a year's delay in final agency action. See *In re Geriatrics, Inc.*, Colorado Dep't of Health Action No. H-77-01 (1977). Since the facility is currently seeking judicial review of the state's order, the process will be more costly and further delayed before the matter is finally settled.

162. This is especially a problem in rural areas such as the southern Colorado region served by Geriatrics, Inc., see note 161 *supra*, which was the only nursing home over sixty miles of mountainous terrain.

163. See note 356 and accompanying text *infra*.

164. Aldrich & Mendkoff, *Relocation of the Aged and Disabled: A Mortality Study*, 11 J. AM. GERIATRICS SOC'Y 185 (1963); Blenker, *Environmental Change and the Aging Individual*, 7 GERONTOLOGIST 101 (1967); Kasl, *Physical and Mental Health Effects of Involuntary Relocation and Institutionalization of the Elderly: A Review*, 62 AM. J. PUB. HEALTH 377 (1972); Kastler, Gray & Carruth, *Involuntary Relocation of the Elderly*, 8 GERONTOLOGIST 276 (1968); Killian, *Effect of Geriatric Transfers on Mortality Rates*, 15 SOCIAL WORK 19 (1970); Kral, Grad & Berenson, *Stress Reactions Resulting from the Relocation of an Aging Population*, 13 CAN. PSYCH. A.J. 201 (1968); Smith & Brand, *Effects of Enforced Relocation on Life Adjustment in a Nursing Home*, 6 INT'L J. AGING & HUMAN DEV. 249 (1975).

dents, especially those who are incompetent or disoriented, develop a physical, psychological and emotional dependence upon their surroundings. This usually happens within six months of admission to a nursing home when the expected stay is indefinite, and the reliance is so complete that any move, whether to another room in the facility or to a second facility, can cause serious emotional and psychological damage, physical stress, and a dramatic increase in the rate of mortality. The serious potential for transfer trauma has given rise to constitutional challenges to individual or group transfers from nursing homes.¹⁶⁵ The potential for irreparable injury under these circumstances usually compels courts to grant temporary injunctive relief.¹⁶⁶ The threat of transfer trauma in moving an individual or an entire population from a nursing home has spurred the development of "transfer planning" regulations and programs designed to protect persons from the dangers of relocation, including advance notice, counseling and patient preparation.¹⁶⁷ Courts have recognized that when the facility itself poses an immediate threat to patient life or safety, when the provider itself decides to terminate Medicaid participation, and when there is no expectation of continued residence in the home (because, for instance, the provider agreement is time limited), the balance between the state's interest in closing the facility expeditiously and the potential of transfer trauma to the residents tips in favor of the state.¹⁶⁸

In view of the problems of time, expense, lack of available beds, transfer trauma and political pressure, it is not surprising that few states have ever revoked a nursing home license or Medicaid certification.¹⁶⁹ Enforcement of licensing standards would be greatly enhanced by the availability of a variety of civil and criminal remedies less severe than closure. Several states have recently enacted such remedies as receiverships, fines, citations, injunctive relief, private citizen actions and the authority to refuse to permit capital construction or facility transfers under Certificate of Need programs. Although most of these remedies have only recently been adopted, and experience under them is limited,

165. See note 153 *supra*.

166. See *Klein v. Mathews*, 430 F. Supp. 1005, 1008-12 (D.N.J. 1977), *aff'd sub. nom. Klein v. Califano*, 586 F.2d 250 (3d Cir. 1978); *Hathaway v. Mathews*, 546 F.2d 227, 231-32 (7th Cir. 1976).

167. NAAG REP., *supra* note 64, at 59-61.

168. *Id.* at 64-65 (citing *Paramount Convalescent Center, Inc. v. Department of Health Care Services*, 15 Cal. 3d 489, 542 P.2d 1, 125 Cal. Rptr. 265 (1975)).

169. See *F. Moss & V. Halamandaris, supra* note 2, at 152-61. But see *Town Court Nursing Center, Inc. v. Beal*, 586 F.2d 280 (3d Cir.), *cert. granted*, 47 U.S. L.W. 3683 (1979) (recognizing an expectancy interest of continued residency that entitled residents to participate in the facility's decertification hearing).

they do offer the potential for a more appropriate and rational array of enforcement powers for state agencies and the public, and are more creative than the unwieldy federal remedy of decertification.

2. State Licensing Remedies¹⁷⁰

a. Receivership

Receivership is a traditional equitable remedy in which the court appoints a third party to manage a party's assets in order to preserve the property at issue in the case for ultimate disposition.¹⁷¹ As noted by the first commentator to suggest this remedy as an alternative to health facility license revocation, "[it] would provide for a temporary takeover of the institution, not for the sake of preserving its financial or economic status, but rather for the sake of putting it into the kind of condition that would best serve the interests of the patients."¹⁷²

The use of receiverships has been expanded by courts¹⁷³ and by state law¹⁷⁴ beyond the protection of physical property to the protection of the civil rights of third parties.¹⁷⁵ At least six states—Connecticut, Kansas, Minnesota, New Jersey, New York and Wisconsin—have enacted legislation authorizing the appointment of receivers to manage nursing homes that fail to comply with licensing standards or otherwise jeopardize resident health and safety.¹⁷⁶ In addition to these involuntary receiverships, facility owners can seek a voluntary receivership of a failing business.¹⁷⁷ In some other states, courts have imposed receiverships upon nursing homes under common law or general statutory powers of equity.¹⁷⁸

170. For an overview of current state licensing remedies, see NAT'L SENIOR CITIZENS' LAW CENTER, *NURSING HOME LAW LETTER*. This monthly publication reports news of general interest to advocates for nursing home residents and updates statutory and litigation developments.

171. See Grad, *Upgrading Health Facilities: Medical Receiverships as an Alternative to License Revocation*, 42 U. COLO. L. REV. 419, 431-32 (1971).

172. *Id.* at 432.

173. See, e.g., *Turner v. Goolsby*, 255 F. Supp. 724 (S.D. Ga. 1965) (county school system placed in receivership when injunction of illegal expenditure of funds to protect rights of black students would result in irreparable injury to white students).

174. See, e.g., N.Y. MULT. DWELL LAW § 309(4),(5) (McKinney 1974).

175. Note, *Receivership as a Remedy in Civil Rights Cases*, 24 RUTGERS L. REV. 115 (1969).

176. See CONN. GEN. STAT. ANN. §§ 19-621a (West Cum. Supp. 1979); KAN. STAT. §§ 39-926, -931, -935, -936 (Cum. Supp. 1978); MINN. STAT. ANN. § 144A.15 (West Cum. Supp. 1978); N.J. STAT. ANN. § 26:2H-42 (West Cum. Supp. 1977); N.Y. PUB. HEALTH LAW § 2862(4) (McKinney 1977); WIS. STAT. ANN. § 50.05 (West Cum. Supp. 1978).

177. See, e.g., N.Y. PUB. HEALTH LAW § 2801(1) (McKinney 1977).

178. See, e.g., *State v. Forest Manor Nursing Home*, No. 77-8555-H (Dallas Dist. Court, 160th Judicial Dist., Aug. 1977).

All these state nursing home receivership statutes permit courts to appoint receivers upon application of various state agencies, usually the state health departments. None authorizes an administrative agency itself to appoint a receiver. Although this authority seems appropriate, at least in emergencies,¹⁷⁹ it would be politically difficult to enact since it would be open to charges of conflict of interest and abuse. Expedited judicial proceedings¹⁸⁰ and the power to order emergency receivers *ex parte*,¹⁸¹ however, appear to provide necessary flexibility in the remedy, while still protecting owners' rights.¹⁸² As is true with many applications for equitable judicial remedies, receivership petitions are given priority on state court calendars and may be heard as soon as five days after they are filed.¹⁸³ While most state laws require a hearing before imposition of a receivership, Connecticut and Wisconsin permit courts to issue receivership orders *ex parte* when an emergency exists that must be remedied immediately to ensure the health, safety and welfare of residents.¹⁸⁴ Several statutes authorize the court to appoint as the receiver either the state health director or his designee¹⁸⁵ or another qualified person.¹⁸⁶

The conditions under which courts may appoint nursing home receivers vary according to the philosophy underlying the remedy. Under New York law, for instance, the court may only appoint a receiver after the state has revoked a facility's license and the licensee has completed administrative and judicial appeals. The receivership, which is limited to eighteen months, is imposed to provide an opportunity for the owner to sell the facility or for the orderly and protected transition of residents to another facility.¹⁸⁷ In other states, however, the receivership is seen as a means of improving management of the facility to protect residents during the actual license revocation proceedings, and thus may be invoked at the commencement of a license

179. See Grad, *supra* note 170, at 433.

180. See, e.g., WIS. STAT. ANN. § 50.05(4) (West Cum. Supp. 1978) (authorizing a court hearing within five days).

181. See, e.g., *id.* § 50.05(5).

182. The New Jersey law significantly extends the receivership remedy by permitting a resident or his guardian to seek it. N.J. STAT. ANN. § 26:2H-38 (West Cum. Supp. 1977).

183. See note 180 *supra*.

184. CONN. GEN. STAT. ANN. § 19-621b(b) (West Cum. Supp. 1979); WIS. STAT. ANN. § 50.05(5) (West Cum. Supp. 1978).

185. See, e.g., MINN. STAT. ANN. § 144A.15(1) (West Cum. Supp. 1978); N.Y. PUB. HEALTH LAW § 2810(2)(A) (McKinney 1977).

186. See, e.g., N.J. STAT. ANN. § 26:2H-42(a) (West Cum. Supp. 1977).

187. N.Y. PUB. HEALTH LAW § 2810(2)(a) (McKinney 1977).

revocation.¹⁸⁸ Some state statutes go still further, permitting the state to apply for appointment of a receiver even without initiating a license revocation action.¹⁸⁹ The preamble to the New Jersey statute, for example, states the purpose of the law to be the elimination of deficiencies. Thus, the state or a resident may seek a receivership upon filing a complaint alleging that the facility is in substantial violation of the health, safety or resident care standards of federal or state law or "any other conditions dangerous to life, health or safety," or that the facility habitually violates those standards.¹⁹⁰ Connecticut law permits application for a receivership for the same reasons,¹⁹¹ but unlike the other statutes, permits a facility owner to defeat an application for receivership if he establishes that he had no actual or constructive knowledge of the violations, that he had insufficient time to correct them, or that they did not exist.¹⁹²

Receivers under all six state laws are generally authorized to operate and manage the facility as a sound business, preserve the owners' assets, and provide for the health, safety and welfare of residents by, among other means, correcting or eliminating the deficiencies that gave rise to the receiver's appointment.¹⁹³ Some laws prohibit major alterations of the physical plant¹⁹⁴ or major expenses without court consent.¹⁹⁵ A particularly creative provision, in light of the recognized manner in which nursing home owners make profits, permits the receiver to refuse to honor preexisting leases, mortgages and contracts that were executed with owners, operators or other controlling persons, or whose rental, price or interest rate "substantially" exceeds a reason-

188. See, e.g., MINN. STAT. ANN. § 144A.15(1) (West Cum. Supp. 1978); WIS. STAT. ANN. § 50.05(2) (West Cum. Supp. 1978).

189. See, e.g., CONN. GEN. STAT. ANN. §§ 19-621a through -621i (West Cum. Supp. 1979); KAN. STAT. §§ 39-954 through -963 (Cum. Supp. 1978); N.J. STAT. ANN. § 26:2H-38, -39 (West Cum. Supp. 1977).

190. N.J. STAT. ANN. § 26:2H-36, -38 (West Cum. Supp. 1977). In Kansas, the state may seek receivership whenever conditions exist that threaten resident health or safety. KAN. STAT. §§ 39-954 through -963 (Cum. Supp. 1978).

191. CONN. GEN. STAT. ANN. § 19-621b, -621c (West Cum. Supp. 1979).

192. *Id.* § 19-621d.

193. *Id.* § 19-621e; KAN. STAT. § 39-959 (Cum. Supp. 1978); MINN. STAT. ANN. § 144A.15(3) (West Cum. Supp. 1978); N.J. STAT. ANN. § 26:2H-42(c) (West Cum. Supp. 1977); N.Y. PUB. HEALTH LAW § 2810(2)(c) (McKinney 1977) (expressly prohibiting receiver from making "major alterations of the physical structure of the facility"); WIS. STAT. ANN. § 50.05(7) (West Cum. Supp. 1978).

194. See, e.g., MINN. STAT. ANN. § 144A.15(3) (West Cum. Supp. 1978); N.Y. PUB. HEALTH LAW § 2810(2)(c) (McKinney 1977).

195. See, e.g., CONN. GEN. STAT. ANN. § 19-621f (West Cum. Supp. 1979); WIS. STAT. ANN. § 50.05(7)(e) (West Cum. Supp. 1978).

able rate.¹⁹⁶ In Connecticut and Wisconsin receivers have special fiduciary duties to residents during transfer. They must aid in location or alternative placement, allowing the resident and guardian to participate in placement selection; assist in discharge planning; and provide orientation to minimize transfer trauma and transport the resident, his records and belongings to the new location.¹⁹⁷

Receiverships terminate when the state issues a new license, the residents are moved, the facility is sold,¹⁹⁸ or the circumstances that occasioned appointment of the receiver are corrected.¹⁹⁹ Notwithstanding these conditions, four states establish limits upon the duration of receivership: ninety days in Wisconsin,²⁰⁰ eighteen months in New York²⁰¹ and Minnesota,²⁰² and twenty-four months in Kansas.²⁰³ While the existence of time limits may assuage due process concerns, they may arbitrarily limit the ability of a receiver to correct problems and to find suitable owners or managers to assume control of the facility.

Recognizing that a major impediment to correcting physical plant or resident care deficiencies may be inadequate financial management, reimbursement or reserves, two statutes authorize state funds for which the receiver may apply.²⁰⁴ Without these appropriations it may be difficult to attract qualified receivers and to permit them adequately to manage facilities, even for a limited time. Arguably, provisions of state laws or constitutions requiring states to provide for the indigent sick²⁰⁵ or the general welfare²⁰⁶ obligate states to fund the additional costs that a receiver legitimately must spend to discharge his duties.

Although owners have frequently alleged that receivership violates due process of law, apparently no one has directly challenged the constitutionality of the nursing home receivership statutes or the exercise of judicial receivership authority to order a receiver for a nursing home

196. CONN. GEN. STAT. ANN. § 19-621e (West Cum. Supp. 1979); WIS. STAT. ANN. § 50.05(9) (West Cum. Supp. 1978).

197. CONN. GEN. STAT. ANN. § 19-621e (West Cum. Supp. 1979); WIS. STAT. ANN. § 50.05(7)(i) (West Cum. Supp. 1978).

198. *See, e.g.*, KAN. STAT. § 39-963 (Cum. Supp. 1978); N.Y. PUB. HEALTH LAW § 2810(2)(e) (McKinney 1977); WIS. STAT. ANN. § 50.05(14) (West Cum. Supp. 1978).

199. *See, e.g.*, N.J. STAT. ANN. § 26:2H-45 (West Cum. Supp. 1977).

200. WIS. STAT. ANN. § 50.05(4) (West Cum. Supp. 1978).

201. N.Y. PUB. HEALTH LAW § 2810(2)(e)(i)(a) (McKinney 1977).

202. MINN. STAT. ANN. § 144A.15(5) (West Cum. Supp. 1978).

203. KAN. STAT. § 39-960 (Cum. Supp. 1978).

204. *Id.*; WIS. STAT. ANN. § 50.05(10) (West Cum. Supp. 1978).

205. CAL. HEALTH & SAFETY CODE § 1750 (West Cum. Supp. 1979).

206. *See, e.g.*, N.Y. CONST. art. 7, § 8; art. 17, § 1.

that has violated health and safety standards. Even if challenged, the exercise of this remedy would seem to fall within the police powers of the state if used to protect the general health, safety and welfare of its citizens. Receiverships have been upheld as a proper exercise of state police power in cases under the New York housing law providing for appointment of receivers to manage housing complexes that endanger health and safety,²⁰⁷ and nursing home receiverships could be constitutionally justified on similar grounds—demonstrably poor conditions that actually threaten resident health, safety or well-being. They may also be upheld as a legitimate condition of licensure that states may impose for violations of the terms of the license. Like license revocation, however, receivership is permissible only if the procedural due process requirements of timely notice and hearing have been met.

All the statutes discussed above provide generally for a court hearing before appointment of the receiver, which clearly satisfies the due process test. The Wisconsin and Connecticut statutes permitting *ex parte* appointments in emergencies involve circumstances in which the state interest in the health and welfare of the nursing home residents is elevated over the interest of the facility owner in maintaining full management and control of the institution,²⁰⁸ and therefore should survive constitutional scrutiny. The receiverships that are time-limited are merely temporary deprivations of property that arguably require less extensive due process protections.

b. Civil Fines and Citations

Receivership may be an appropriate remedy for serious violations that jeopardize the health and safety of all facility residents and that can best be corrected by new management; less severe penalties than either license revocation or receivership, however, can be administratively simpler and can often force facilities to correct violations that are not necessarily life threatening, such as those of individual care and certain sanitation standards. Several states have developed systems of "citations," whereby facilities are cited for violations that are classified according to severity. The notices of citations typically are publicly displayed and may be accompanied by fines for continued violation. The number of citations issued to each facility can be the basis for reimbursement, for ranking facilities according to the quality of care they

207. See, e.g., *In re Dep't of Bldgs.*, 16 N.Y.2d 915, 212 N.E.2d 154, 264 N.Y.S.2d 700 (1965); *In re Dep't of Bldgs.*, 14 N.Y.2d 291, 200 N.E.2d 432, 251 N.Y.S.2d 441 (1964).

208. See, e.g., *North American Cold Storage Co. v. City of Chicago*, 211 U.S. 306 (1908).

provide, and for refusal to admit new residents. California adopted the first citation system in 1973²⁰⁹ and several other states have patterned legislation after it.²¹⁰

Under the California citation system, the state licensing agency is obligated to classify all nursing home licensing standards according to their seriousness and relationship to resident health and safety.²¹¹ Class A violations are those posing an imminent danger to residents or a substantial probability that serious harm or death will result.²¹² Class B violations are those directly related to health, safety or security.²¹³ State surveyors inspecting facilities must classify each violation they find as either Class A or B and issue a citation within three working days.²¹⁴ Class A violations must be remedied immediately;²¹⁵ Class B violations must be remedied within the time set forth on the citation.²¹⁶

Final citations (after appeals) must be prominently posted in public view until the deficiencies are corrected.²¹⁷ Financial penalties may be imposed for the two types of citations: \$1000-\$5000 for Class A violations and \$50-\$250 for Class B violations.²¹⁸ For every day that a Class A or B violation goes unabated beyond the time allowed for its correction, facilities are subject to penalties of \$50.²¹⁹ The state may collect treble damages against facilities penalized for repeating a violation within twelve months;²²⁰ however, since penalties for Class B violations are only assessed if the violations remain uncorrected after the allotted time, the treble damages sanction is rarely used with respect to those violations.²²¹

209. CAL. HEALTH & SAFETY CODE §§ 1417-1439 (West Supp. 1979).

210. See, e.g., CONN. GEN. STAT. ANN. §§ 19-607 to -613 (West Cum. Supp. 1979); IOWA CODE ANN. §§ 135C.36-135C.48 (West Cum. Supp. 1978). See also KAN. STAT. § 39-923(2) (Cum. Supp. 1978); MINN. STAT. ANN. § 144A.10 (West Cum. Supp. 1978); N.J. STAT. ANN. § 30:11-4(a) (West Cum. Supp. 1977); N.Y. PUB. HEALTH LAW § 2803(3), (6) (McKinney 1977); OHIO REV. CODE ANN. § 3721.17(E) (Page Cum. Supp. 1978). Wisconsin has for many years had a citation system accompanied by monetary "forfeitures." WIS. STAT. ANN. § 50.04 (West Cum. Supp. 1978).

211. CAL. HEALTH & SAFETY CODE § 1426 (West Cum. Supp. 1979).

212. *Id.* § 1424(a).

213. *Id.* § 1424(b).

214. *Id.* § 1423.

215. *Id.* § 1424(a).

216. *Id.* § 1424(b).

217. *Id.* § 1429.

218. *Id.* § 1424.

219. *Id.* § 1425.

220. *Id.* § 1428(e).

221. JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 14. The Wisconsin law avoids this problem by permitting treble damages to be collected if notice of repeat violations has been

In the three years of experience with the California citation system, numerous problems have arisen with its structure and implementation. A Legislative Audit Committee identified some of these issues: state agency delays in filing complaints to enforce citations and penalties, ineffective use of the treble damages provision, and lack of enforcement of Class B violations.²²² The last problem is particularly troubling, as it indicates the means by which facilities can, at least partially, avoid the law. Because facilities do not want Class B citations that have been corrected within the time limits on the citations to appear in public records, they will contest the citations through administrative review. The attorney general's office will typically not prosecute the citations because to do so would waste time and resources since the violation has been corrected. The citations are dismissed, even though they were legitimately issued, and are erased from public record, so that even if the violations are repeated they cannot form the basis for treble damages because no previous penalty has been assessed.²²³

Another difficulty inherent in the citation-penalty system concerns the role of surveyors—are they consultants or police? Surveyors who have difficulty citing facilities for licensing violations are even less comfortable knowing that a citation is likely to lead to a financial penalty. Furthermore, surveyors require careful training in the proper methods of documenting violations in order to support citations through the appeal process. Still another problem is the emphasis of the California law on violations of licensing standards that may not directly relate to resident health and safety. While the California licensing standards are extremely detailed and comprehensive,²²⁴ they maintain the structural orientation and medical model typical of state licensing and federal certification regulations, which generally miss the mark of examining care actually needed by and delivered to nursing home residents.

Litigation on the constitutionality of a penalty system has thus far only occurred in California. In one of the early state prosecutions of a citation and penalty assessment, *Lackner v. Perkins*,²²⁵ a state superior court dismissed the complaint on the grounds that the statute deprived the facility of due process. The court reasoned that because a facility

given rather than only when a penalty has been assessed. WIS. STAT. ANN. § 50.04(5)(a)(5) (West Cum. Supp. 1978).

222. JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 14-25.

223. *Id.*

224. 22 CAL. ADMIN. CODE §§ 72301-72395 (West Cum. Supp. 1979).

225. No. 386673 (Sup. Ct. of San Diego Cty. Oct. 27, 1977), *rev'd*, 91 Cal. App. 3d 433, 154 Cal. Rptr. 138 (1979).

can either pay the minimum amount set forth in the statute or contest the citation,²²⁶ the law improperly penalizes the exercise of the statutory right to contest citations through the appeal process. Seizing that decision, the state association of proprietary nursing homes challenged the constitutionality of the entire citation system on several due process grounds in *California Association of Health Facilities v. Director, Department of Health*.²²⁷ In addition to relying on the *Perkins* holding, plaintiffs asserted that the statute was unconstitutionally vague in its definitions of Class A and B violations because it did not provide standards by which licensees could know what conduct was prohibited. Further, they contested the statute's delegation to licensing agencies of the authority to adopt licensing regulations, classify violations, and fix and assess penalties because it was made without specific legislative standards and because it created a conflict of agency functions.²²⁸ Finally, plaintiffs asserted that the informal conference procedure did not satisfy due process.²²⁹

Because other states have adopted penalty systems that may face similar challenges, it is instructive to examine the issues raised by *Perkins* and *Health Facilities*. Whether the California statute's definition of citations is sufficiently precise is debatable.²³⁰ Arguably, even without adequate standards in a statute, a court will not invalidate it if the law establishes appeal procedures adequate to safeguard the rights of persons subject to administrative action.²³¹ The question of administrative rulemaking authority, however, and the conflict between legisla-

226. CAL. HEALTH & SAFETY CODE § 1428(b) (West Cum. Supp. 1979). The Iowa law does not provide this choice; it permits the cited licensee either to contest the citation or pay the entire fine. IOWA CODE ANN. § 135C.41 (West Cum. Supp. 1978).

227. No. 73J-028 (Sup. Ct. of San Francisco City, filed Nov. 25, 1977) (preliminary injunction denied March 24, 1978), No. 442-43 (1st Dist. June 1, 1978) (writ of prohibition denied).

228. The Department of Health had used the same person to write citations and conduct the informal conferences, but changed this practice before the case was filed. Conversation with Bill Smith, Chief of Health Services Section, Licensing and Certification Division, California Dep't of Health (Dec. 23, 1977). The Iowa statute specifically forbids the person writing the citation from officiating at the informal conference. IOWA CODE ANN. § 135C.42 (West Cum. Supp. 1978).

229. Contrary to the nursing home association's contention that the informal hearing violates due process of law, it would appear that it meets the rudiments of due process as stated in such recent cases as *Case v. Weinberger*, 523 F.2d 602 (2d Cir. 1975), and *Weinberger v. Salfi*, 422 U.S. 749 (1975). Furthermore, since an entire trial de novo is available in the state court to a licensee dissatisfied with the hearing officer's decision, that subsequent full trial satisfies the concerns of due process. 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 7.10 (1958).

230. Compare *People v. Barksdale*, 8 Cal. 3d 320, 503 P.2d 257, 105 Cal. Rptr. 1 (1972) and *McMurty v. Board of Medical Examiners*, 180 Cal. App. 2d 760, 4 Cal. Rptr. 910 (1960) with *People v. Hellner*, 43 Cal. 2d 715, 227 P.2d 393 (1954) and *People v. Fowler*, 178 Cal. 657, 174 P. 892 (1918).

231. See K. DAVIS, *supra* note 229, at § 7.10.

tive and enforcement functions seems to be well settled.²³² All licensing agencies establish standards for their licensees and then enforce compliance with those standards through administrative proceedings. It is the violation of a licensing standard that subjects a facility to a citation and penalty. Clearly the agency has the power to revoke a facility's license for violation of its standards, and the state agency is acting no differently when it invokes the more lenient remedy of a penalty short of license revocation. As in the case of the receivership power, the agency seems to be acting under a delegation of the state's police powers, but employing less severe remedies, and a court should uphold the constitutionality of the system.

Perhaps the most serious challenge to the citation-penalty system was that accepted by the court in *Lackner v. Perkins*—that the statute coerced facilities into paying a minimum penalty and forfeiting their appeal rights, a Hobson's choice that the court felt rose to unconstitutional status.²³³ Because a facility always retains the right to appeal a particular penalty, the logic of this decision is curious. Rather than being comparable to the constitutional waiver of a right to jury trial as a quid pro quo for the guarantee that a prosecutor would not seek capital punishment,²³⁴ the citation law seems more analogous to a common penalty system for traffic violations, under which the cited driver may pay a minimal fine rather than contest the citation in court, where he might obtain dismissal of the penalty but could also be subject to a more severe fine.²³⁵ Since the legislature adopted the provision to permit a facility to pay a minimum fine, and thereby avoid the imposition of a possibly stiffer fine on appeal, in order to save the facility and the state the time and expense of the appeal process, it is ironic that the choice formed the basis for the *Perkins* court's invalidation of the statutory scheme. Without that option,²³⁶ apparently the court would not have invalidated the law. Although the *Perkins* decision was recently reversed on appeal,²³⁷ because the nursing home association's general challenge to the statute in *Health Facilities* has not been finally decided

232. See, e.g., *People v. Adams*, 43 Cal. App. 3d 697, 117 Cal. Rptr. 905 (1974); *Nardoni v. McConnell*, 48 Cal. 2d 500, 310 P.2d 644 (1957).

233. No. 386673 (Sup. Ct. of San Diego Cty., Oct. 27, 1977).

234. *United States v. Jackson*, 390 U.S. 570 (1968).

235. See, e.g., CAL. VEH. CODE §§ 40512, 42004 (West 1971). See also Note, *California Traffic Law Administration*, 12 STAN. L. REV. 387, 400-401 (1960).

236. See, e.g., IOWA CODE ANN. § 135C.41 (1)(a) (West Cum. Supp. 1978), which does not provide such a choice.

237. 91 Cal. App. 3d 433, 154 Cal. Rptr. 138 (1979).

by the superior court pending that appeal, legislative authority to adopt a citation-penalty system of this scope remains unclear.

Despite questions about the constitutionality of the citation-penalty approach, an examination of its effectiveness over the course of its three-year history remains warranted. California state officials, who believe that the system is working effectively to improve patient care in nursing homes, cite the decrease in the number of citations from the first to the second year of operation, the decrease in the average number of facility deficiencies during that time, and expedited facility correction of violations.²³⁸ Few citations have been challenged, and most of those have been sustained.²³⁹ Administration of the system has been expensive, costing over \$150,000 in legal fees for the state agency in 1976,²⁴⁰ and about two hours per citation of surveyor and clerical time²⁴¹ to process the 2500 Class A and B citations.²⁴² Of approximately \$1,180,000 in penalties assessed against facilities from October 1975 through March 1977, the state collected \$46,000.²⁴³ Costs of collection to the state, therefore, substantially exceed actual returns to the treasury, but may be offset by the intangible benefit of improved health and well-being of nursing home residents.

A general problem with any system of penalties is that a monetary forfeiture will probably come directly out of patient care funds, since it is unlikely that the facility administrator or owner would pay the penalty out of profits. Thus, the statutes should prohibit payment of the penalties from direct care funds and should prohibit them as reimbursable costs under Medicaid. While such prohibitions might be difficult

238. Interview with Bill Smith, Chief of Health Services Section, Licensing and Certification Division, California Dep't of Health (Dec. 23, 1977). See also DIVISION OF LICENSING AND CERTIFICATION, STATE DEP'T OF HEALTH, REPORT TO THE STATE LEGISLATURE ON THE LONG-TERM CARE, HEALTH, SAFETY AND SECURITY ACT OF 1973, at 1, 16 (Feb. 1977) [hereinafter cited as HEALTH DEP'T REP.].

239. In 1976, 23% of the 3250 citations issued by the Health Department were contested. HEALTH DEP'T REP., *supra* note 238, at 17 & Appendix I. Of the 90 Class A citations contested, 60% were sustained, 20% were dismissed entirely, and 20% were either reduced in penalty amount or reclassified as a Class B violation. *Id.* at 17 & Appendix J. Of the 650 Class B citations contested, 60% were sustained, 17% were dismissed, and 23% were reduced in penalty amount. *Id.* at 17 & Appendix K. During that year, 36 cases were appealed to court; two were decided in favor of the state and one, *Perkins*, was decided against the state. *Id.* at 17.

240. JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 34-35. Facility owners, on the other hand, have estimated the costs of contesting a citation to be between \$900 and \$1300. See Letter from Western Medical Enterprises, Inc., to Joint Legislative Audit Committee (Aug. 30, 1977), in JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 42-43.

241. Interview with Bill Smith, Chief of Health Services Section, Licensing and Certification Division, California Dep't of Health (Dec. 23, 1977).

242. See HEALTH DEP'T REP., *supra* note 238, at 15.

243. See JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 48 (Table 3).

to enforce because they require a careful financial audit to trace the accounting for penalties, failure to resolve this problem will accrue to the detriment of the nursing home residents, whose interests the penalty system was designed to protect.

Since most of the penalty systems were recently enacted,²⁴⁴ other states have had little experience with them. State agencies, however, report success in their application to the problem of improving nursing home care,²⁴⁵ and, in combination with other remedies, a system of civil fines seems to be a useful approach to quality enforcement.

c. Other State Licensing Remedies

As an adjunct to licensing authority, several other remedies are available to state licensing agencies, including injunctive relief, suspension of public referrals and admissions, consideration of past performance in license renewals and reduction of bed quotas.

(i) Injunctions

State agencies or attorneys general acting on their behalf are typically empowered by statute to seek compliance with the laws they administer through injunctive relief.²⁴⁶ In addition to this general statutory authorization, several states have enacted broad consumer protection laws that prohibit deceptive practices and unconscionable conduct and permit state attorneys general to enforce them through suits for damages and injunctions.²⁴⁷ These laws have been liberally interpreted in cases involving nursing homes to prohibit patient neglect, infringement of patients' rights, and failure to notify attending physicians of changes in patient status, to maintain sanitary conditions, to provide adequate nursing care and to maintain sufficient staff.²⁴⁸ Other states have enacted specific legislation authorizing state agencies to enforce nursing home licensing laws and regulations through injunctions.²⁴⁹

244. See note 210 *supra*.

245. See, e.g., Letter from Dana L. Petrowsky, Director, Health Facilities Licensure Program, Iowa State Dep't of Health, to Author (Aug. 31, 1978) (copy on file in the office of the *North Carolina Law Review*).

246. See, e.g., CAL. CIV. CODE § 3369 (West 1970).

247. See, e.g., TEX. BUS. & COM. CODE ANN. tit. 2, §§ 17.41-.63 (Vernon Cum. Supp. 1978).

248. See, e.g., *id.*, enforced against a nursing home in *State v. Southwest Medplex*, No. 77-1587 (Dist. Ct., Travis County) (TRO issued Feb. 23, 1978).

249. See, e.g., CAL. HEALTH & SAFETY CODE § 1430 (West Supp. 1979); MINN. STAT. ANN. § 144a.12 (West Cum. Supp. 1978); N.J. STAT. ANN. § 30:11-4(a) (West Cum. Supp. 1978); N.Y. PUB. HEALTH LAW § 2801-C (McKinney 1977).

Injunctive relief is in theory particularly appropriate to remedy violations of licensing standards: courts of equity are familiar and comfortable with issuing injunctive orders; hearings and relief can be obtained expeditiously in urgent cases; and unlike financial penalties, which do not directly assure correction of the licensing violations and which may actually impair provision of resident care services, injunctions can directly mandate correction of violations. On the other hand, although injunctive relief is couched in prohibitory language, it most frequently requires affirmative action on the part of the facility. For example, an order to "refrain from failing to provide adequate nursing care" really mandates that the facility provide sufficient personnel, services and supplies to meet resident needs. Some courts, therefore, hesitate to issue injunctions, especially when they will require oversight and active judicial involvement in nursing home administration and management. Furthermore, obtaining an order does not guarantee compliance. The penalty for contempt is usually a fine or jail sentence, but courts may be reluctant to hold nursing home owners or operators in contempt if they are making any apparent attempt to correct the deficiencies at issue. The effectiveness of the injunctive remedy, therefore, depends upon the willingness of the facility management to comply and its perception of the consequences of refusing to do so, that is, the likelihood of the court taking aggressive steps to enforce its order.

(ii) Suspension of Referrals

Because nursing homes rely heavily upon public financing under Medicaid,²⁵⁰ a potentially powerful agency remedy for violations of licensing standards is suspension of resident referrals by public agencies while violations remain uncorrected. This remedy is justified both to prompt compliance with standards and to protect potential residents from entering facilities with deficiencies, although the latter ground suggests that the state ought to remove or otherwise protect the existing residents of the facility as well. The California citation law prohibits public agencies from referring residents to facilities with any uncorrected Class A violations or five or more Class B violations, making an important exception for facilities in areas of shortage.²⁵¹ A noteworthy quid pro quo for this limitation on public referral to deficient facilities is the state licensing agency's obligation annually to notify public agencies of facilities without any A or B violations and the obligation im-

250. See note 12 *supra*.

251. CAL. HEALTH & SAFETY CODE § 1434 (West Cum. Supp. 1979).

posed upon those agencies to give such facilities priority in referring public patients.²⁵² Wisconsin law goes further, requiring the state to prepare a monthly list of facilities with Class A violations or five or more of any violations for which a plan of correction has not been filed, implemented or accepted.²⁵³ Facilities on that list may not accept public patients,²⁵⁴ as under California law, nor may they admit *any* new patients—public or private—while a Class A or five or more Class B citations remain uncorrected.²⁵⁵ Referral suspension, however, has only been imposed sporadically; officials of the California licensing agency, for example, indicate that while the referral system is functioning effectively in Los Angeles County, it is not used in other parts of the state.²⁵⁶

Regardless of the effectiveness of referral suspensions, their imposition, at least under the California citation statute, is constitutionally suspect. Because a suspension seems to constitute as much of a deprivation of property as a revocation of a facility's license or Medicaid certification, its imposition arguably requires a prior hearing in order to comport with due process of law, unless the suspension can be justified on the basis of an emergency.²⁵⁷ The Wisconsin law expressly permits facilities to seek a hearing to contest the state's determination to suspend referrals or admissions.²⁵⁸ It is not clear, however, whether a similar hearing is required under the California law. While other sections of the citation statute refer to "final" citations, occurring after opportunity for appeal,²⁵⁹ the referral section prohibits referrals when there are "uncorrected violations."²⁶⁰ Because a violation can remain uncorrected while a citation is being contested, it may be argued that the legislature did not intend to permit hearings before the suspension of referrals. Although this issue has apparently not been raised, were the California statute so construed, it might be found constitutionally deficient.

252. *Id.*

253. WIS. STAT. ANN. § 50.04(4)(d) (West Cum. Supp. 1978).

254. *Id.* § 50.04(4)(d)(2).

255. *Id.* § 50.04(4)(d)(3).

256. JOINT LEGISLATIVE AUDIT COMMITTEE, *supra* note 6, at 33-34; interview with Aileen Adams, formerly with Los Angeles City Attorney's Office (Nov. 25, 1977).

257. For situations in which a particular facility might not be seriously harmed, a subsequent hearing might suffice. In any case, an expeditious and informal hearing would seem to satisfy due process. See notes 150-51 and accompanying text *supra*.

258. WIS. STAT. ANN. § 50.04(4)(e) (West Cum. Supp. 1978).

259. CAL. HEALTH & SAFETY CODE §§ 1428(a), 1429(a) (West Cum. Supp. 1979).

260. *Id.* § 1434.

States without specific legislation authorizing suspension of referrals can accomplish similar ends through publicizing the results of inspections and/or ranking facilities according to the number and severity of deficiencies.²⁶¹ Informed public agencies and prospective nursing home residents and their relatives can then make decisions about nursing home placement according to the relative quality of the facilities indicated by this rating.

(iii) Reducing Bed Quotas

Another creative enforcement mechanism that can be employed by state licensing agencies is to reclassify a facility not providing a given level of care to the level of care it can in fact provide, or to reduce the bed quota of a facility commensurate with the type, quality and quantity of care it can provide. West Virginia has adopted such legislation,²⁶² permitting the state agency to reclassify or reduce bed quotas upon a finding "that the licensee is not providing adequate care under the facility's existing classification or quota, and that reclassification, reduction in quota or both would place the licensee in a position to render adequate care."²⁶³ Since this provision was only recently enacted, there has been no experience with its implementation. Obviously, however, reclassification raises the procedural due process problems discussed earlier. In addition, the usefulness of this approach is limited to situations in which a reduction in bed capacity or classification, for example, from SNF to ICF, would remedy a violation of a licensing standard, such as an insufficient number of registered nurses. Within these constraints, however, it provides the potential for state agencies to tailor enforcement mechanisms to precise license violations.

(iv) Consideration of Past Performance

A final license remedy that states are adopting is consideration of the past performance of a facility in determining whether to renew an annual license for that facility or others involving the same owners and managers. The West Virginia licensing statute directs the state agency to issue a license to a facility whose principals and controlling persons have not had licenses revoked during the previous five years.²⁶⁴ Kansas law permits the state to deny a nursing home license to any person

261. See, e.g., N.Y. PUB. HEALTH LAW § 2803(c) (McKinney 1977).

262. See W. VA. CODE § 16-5C-11(a) (Supp. 1978).

263. *Id.* § 16-5C-11(c).

264. *Id.* § 16-5C-6(b)(1).

who has wilfully or repeatedly violated the state licensing standards, has failed to "assure that nutrition, medication and treatment of residents" accord with acceptable medical practice, or has assisted in any violation of the licensing standards.²⁶⁵ Similarly, Colorado regulations permit the state agency to consider a licensee's compliance with state licensing and Medicaid-Medicare certification standards in determining whether the licensee is "fit" to hold a license.²⁶⁶ New Jersey law forbids the state agency from issuing a license to a person "who has been twice found guilty of violating" the state licensing standards by a court or who has admitted guilt.²⁶⁷ Minnesota law forbids issuing a license to a facility if its controlling persons operated another nursing home during the previous two years with uncorrected violations for which a fine was assessed and collected, if there were two or more violations creating an imminent risk of harm to a resident, or if there were ten or more violations of any type.²⁶⁸ These statutes vary in the weight that a state agency must accord past licensing violations, and in the weight given to the nature of past violations. Furthermore, all of them do not clearly permit licensing agencies to look at the quality of care in other facilities owned or managed by the licensee.²⁶⁹ To the extent that the licensing standards do indicate quality of care, this authority to consider past performance in all facilities where the licensee exercises management or control is an important tool for licensing agencies to employ in continuing quality enforcement, especially as nursing homes are increasingly multiply-owned or operated by chains.

(v) Certificate of Need Authority

Particularly since enactment of the National Health Planning and Development Act of 1974,²⁷⁰ many states have adopted programs by which they review the necessity and desirability of capital expansion, construction, or equipment acquisition by or on behalf of health facilities.²⁷¹ These "certificate of need" programs prohibit health facilities, including hospitals and nursing homes, from making certain capital ex-

265. KAN. STAT. § 39-923(9)(b) (Cum. Supp. 1978).

266. Standards for Health Facilities Licensure, ch. 2, § 2.4.1.4.3 (1977). *See also* WIS. STAT. ANN. § 50.03(4)(a)(2) (West Cum. Supp. 1978).

267. N.J. STAT. ANN. § 30:11-1 (West Cum. Supp. 1978).

268. MINN. STAT. ANN. § 144A.04(4) (West Cum. Supp. 1978).

269. Compare the Colorado Regulations, *supra* note 266, and the Minnesota statute, *supra* note 268, with the Kansas, New Jersey and West Virginia statutes, *supra* notes 265, 267 & 264.

270. National Health Planning and Development Act of 1974, Pub. L. No. 93-641, 88 Stat. 2225 (1974) (codified in scattered sections of 42 U.S.C.).

271. *See generally* Wing & Craig, this Symposium.

penditures without the approval of local and state health planning agencies.²⁷² It is not made clear in either the federal legislation or in state certificate of need laws whether quality of care is one of the criteria that can be used to make certificate of need decisions. Local and state certificate of need agencies should examine the quality of care prior to approval of requests by nursing homes that want to make further capital expenditures. In determining the need for nursing home beds, states should also discount the availability of poor quality beds.²⁷³ These approaches may be difficult without explicit state statutory authority, and few states have incorporated such criteria into their certificate of need programs. The Colorado law, however, expressly requires a certificate for the acquisition of a nursing home by lease or purchase if the planning agencies determine that a poor quality of care was provided by the acquiring owner or lessee in other facilities it had managed or owned.²⁷⁴ Under this law the planning agencies examine the record of quality of care of prospective owners and lessees, using compliance with licensing standards and Medicaid-Medicare certification requirements as quality indicators.²⁷⁵ Inquiry into the compliance with similar standards in other states has resulted in the Colorado state agency's refusal to issue certificates of need for prospective owners or lessees to acquire facilities in the state when those persons have had a record of providing poor quality care in facilities in other states in which they were principals.²⁷⁶

Although the state licensing agency may be separate from the agency performing certificate of need and health planning, the potential for coordination between these agencies, using planning and certificate of need power to assist in enforcement of quality of care in nursing homes, should not be overlooked. It is regrettable that licensing-certification functions and health planning-certificate of need functions have rarely been closely coordinated and that the power of each of these programs has been diluted as a result.²⁷⁷

272. 42 C.F.R. § 123.404 (1977).

273. See OHIO REP., *supra* note 6, at 10.

274. COLO. REV. STAT. § 25-3-506(1)(i) (Cum. Supp. 1978).

275. COLORADO DEPT OF HEALTH, CERTIFICATE OF NEED PROJECT REVIEW MANUAL § I(A)(9)(c) (1979).

276. The Colorado Department of Health refused to issue a certificate of need to the owner of a Texas nursing home chain to purchase a Colorado nursing home on the ground that the owner had a poor quality record in its Texas facilities.

277. The Colorado Department of Health was organized with both planning and licensing under one assistant director. Few other state agencies are thus constituted.

(vi) Criminal Sanctions

While operating a nursing home without a license is typically defined as a misdemeanor under state law,²⁷⁸ violations of licensing standards are not generally defined as criminal.²⁷⁹ Under its general authority to prosecute violations of state law, however, the Los Angeles City Attorney's Office in 1975 and 1976 undertook a major criminal investigation and prosecution of nursing home violations of state licensing standards, including failure to provide for therapeutic diets, commingling of resident funds, unsanitary conditions, insufficient staff, medication charting errors, and failure to provide required resident care.²⁸⁰ Out of fifteen prosecutions initiated in 1975, the office obtained fourteen convictions, resulting in fines up to \$15,000 and/or probation. Most of the owners convicted of the misdemeanors sold their facilities.²⁸¹ Officials in the City Attorney's Office felt that using the criminal process improved quality of care in nursing homes since they did not receive further complaints about any of the same facilities after the successful prosecutions. These officials also felt that criminal actions were more successful than civil ones, because, although harder to prove, they had a greater deterrent impact and were brought to trial more quickly than civil actions because of the expedited discovery proceedings and acceleration of criminal cases in the courts.²⁸² Despite this apparent success in Los Angeles, the criminal enforcement effort has not been replicated elsewhere in California.²⁸³ Furthermore, while prosecutors can prove specific acts of patient abuse, it may be difficult to assign criminal responsibility for patient *neglect* because of the variety of persons generally responsible for patient care in nursing homes.²⁸⁴

278. See, e.g., IOWA CODE ANN. § 1352C21(1) (West Cum. Supp. 1978); MINN. STAT. ANN. § 144A.02(2) (West Cum. Supp. 1978); WIS. STAT. ANN. § 50.03(1) (West Cum. Supp. 1978).

279. But see N.Y. PUB. HEALTH LAW § 12-b (McKinney 1977); OHIO REV. CODE ANN. § 3721.99 (Page Cum. Supp. 1978).

280. Interview with Aileen Adams, formerly of Los Angeles City Attorney's Office (Nov. 25, 1977).

281. *Id.*

282. *Id.*

283. *Id.*

284. See NAAG REP., *supra* note 64, at 52. Another problem with criminal prosecution for nursing home licensing violations is the allegation that evidence gained through unannounced inspections is the fruit of an unlawful search and seizure that violates the fourth amendment of the Constitution. See, e.g., *People v. White*, 259 Cal. App. 2d 936, 65 Cal. Rptr. 923 (1968); *Uzzillia v. Commissioner*, 47 A.D.2d 492, 367 N.Y.S.2d 795 (1975). It has also been argued that to subpoena records of nursing homes that are sole proprietorships would violate the fifth amendment protection against self-incrimination. See, e.g., *Sigety v. Hynes*, 83 Misc. 2d 648, 372 N.Y.S.2d 771, *aff'd*, 49 A.D.2d 700, 373 N.Y.S.2d 848, *rev'd*, 38 N.Y.2d 260, 342 N.E.2d 518, 379 N.Y.S.2d 724

Some states have enacted laws prohibiting fraud or concealment of facts to obtain Medicaid reimbursement, which includes obtaining Medicaid payment for services, such as nursing home services, not actually provided to beneficiaries as needed.²⁸⁵ The Medicare-Medicaid Anti-Fraud and Abuse amendments of 1977,²⁸⁶ a recent addition to the Social Security Act, create federal penalties for making false statements in applications for Medicare and Medicaid reimbursement. The amendments also increase the rate of federal funding to ninety percent for states that establish Medicaid Fraud Control Units and coordinate them with the state Medicaid agency, attorney general's office and district attorneys.²⁸⁷ The units are specifically responsible for receiving complaints about abuse and neglect of patients in Medicaid health facilities and prosecuting violations under criminal law or referring them to other state agencies for appropriate actions.²⁸⁸ Despite the generous federal financing of these units and their potential for prosecuting serious cases of resident abuse and neglect, few states have established them.²⁸⁹

3. Enforcement Actions by Private Parties

Traditionally, private parties injured by the failure of health institutions to meet standards of care will assert their right to collect damages through civil actions for negligence, assault or battery. A prerequisite for recovery in these tort cases, however, is that the plaintiff's injury be measurable in monetary damages, calculated according to life expectancy and earning potential.²⁹⁰ While clear standards have been developed to evaluate the loss of life or limb for persons of young age or wage-earning capacity, it has been assumed that the life or

(1975); *Lewis v. Hynes*, 82 Misc. 2d 256, 368 N.Y.S.2d 738 (1975). In New York, where both these contentions have been extensively litigated, courts have rejected them. See *Uzzillia v. Commissioner*, 47 A.D.2d 492, 367 N.Y.S.2d 795 (1975); *Sigety v. Hynes*, 83 Misc. 2d 648, 372 N.Y.S.2d 771 (1975). The New York Special Prosecutor's Office has obtained numerous criminal convictions for nursing home fraud and abuse. NEW YORK SPECIAL PROSECUTOR'S OFFICE, SECOND ANNUAL REPORT TO GOVERNOR CAREY 12 (1977).

285. See, e.g., MICH. COMP. LAWS § 400.601 (MICH. STAT. ANN. § 16.614(3)) (Cum. Supp. 1978); N.J. STAT. ANN. § 30:40-17 (West Cum. Supp. 1978).

286. 42 U.S.C. §§ 1395nn, 1396h (1976).

287. *Id.* § 1396(q).

288. *Id.* § 1396(q)(4); 43 C.F.R. § 455.300(f) (1977).

289. As of December 20, 1978, only 22 states had requested HEW certification for their Medicaid Fraud Control Units and only 19 had received certification. [1979] MEDICARE & MEDICAID GUIDE (CCH) ¶ 252. Units in Colorado, California and Louisiana have been undermined by personal and political difficulties and scandals.

290. Damages for personal injury are usually based in part on actuarial life expectancy. See D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 549 (4th ed. 1975).

health of an elderly person in a nursing home is incapable of financial evaluation and therefore cannot be compensated in a suit for damages. Despite this widespread view, some residents have recovered substantial awards for violations of state licensing and Medicaid certification standards,²⁹¹ and private litigation on behalf of nursing home residents is increasing.²⁹²

Private litigation is made even more difficult to pursue, however, if the plaintiff must remain in the institution, where he legitimately fears direct or indirect retaliation. For this reason, many dissatisfied and/or abused residents of nursing homes do not even complain about mistreatment, much less pursue legal remedies for it. At least one court, however, has permitted the use of pseudonyms for plaintiffs in such cases to preserve their anonymity and protect them from retaliatory treatment.²⁹³ Additional protection is available through state statutes that expressly prohibit facilities from retaliating against persons filing complaints with state agencies or proceeding against the facilities directly.²⁹⁴ These statutes create a rebuttable presumption that any discriminatory treatment within a given time of the resident's action was done in retaliation for the action.

Having overcome the reluctance of courts, private attorneys and residents to pursue private civil litigation for patient abuse or neglect, the question becomes what causes of action can an aggrieved plaintiff assert. The most traditional cause of action is one for injury resulting from the negligence of facility staff—either physical abuse, such as the improper use of restraints or medication, lack of protection from other patients,²⁹⁵ or neglect, such as the failure to provide care resulting in decubitus ulcers or failure to observe a medically prescribed diet.²⁹⁶ Employees directly responsible for such acts can be held accountable for them, and employers can be subjected to liability for employee misconduct under the doctrine of respondeat superior.²⁹⁷ The extent to

291. In one case, plaintiff class of nursing home residents obtained \$16,000 in compensatory damages and \$500,000 in punitive damages in a challenge to a nursing home's conversion of patient care funds. *Brandenburg v. Charapata*, No. 422-112 (Multnomah City, Or. Cir. Ct., 1978).

292. *See, e.g., Smith v. O'Halloran*, No. 75-M-539 (D. Colo., June 5, 1975).

293. *Resident v. Emmanuel Family Training Center, Inc.*, No. C78-477 (D. Ohio, 1978). The court applied the test of anonymity from *Roe v. Wade*, 410 U.S. 113, 124 (1973), whether "disclosure of a litigant's name would subject the litigant to undue and unnecessary injury."

294. *See, e.g., CAL. HEALTH & SAFETY CODE* § 1432(a), (b) (West Cum. Supp. 1979); *IOWA CODE ANN.* § 135C.46 (West Cum. Supp. 1978); *OHIO REV. CODE ANN.* § 3721.17(G) (Page Cum. Supp. 1978).

295. *See, e.g., Bezark v. Kostner Manor, Inc.*, 29 Ill. App. 2d 106, 172 N.E.2d 424 (1961).

296. *See, e.g., Hendricks v. Sanford*, 216 Or. 149, 337 P.2d 974 (1959).

297. *See, e.g., Jefferson Hosp., Inc. v. Van Lear*, 186 Va. 74, 41 S.E.2d 441 (1947).

which a facility is responsible for the conduct of individuals it does not employ is unclear. Under the doctrine espoused in *Darling v. Charleston Community Memorial Hospital*,²⁹⁸ health facilities are responsible for the negligent acts of not only their employees, but also those persons practicing independently within the institution, as long as the facility had reason to believe the person might be seriously negligent and the facility had the opportunity to protect the patient against the harm. Thus, it would appear that facilities have a responsibility for protecting residents against the gross negligence of outside consultants and attending physicians and that this doctrine may be applied in some circumstances to simply negligent treatment.²⁹⁹

In determining the standard of care to be applied in a case of nursing home negligence, it may be possible to assert that the federal Medicaid Conditions of Participation and state licensing standards establish the underlying duty.³⁰⁰ Furthermore, although the standard of care remains that of the reasonable man, the frailty of nursing home residents may require the facility to exercise the greater care commensurate with the physical condition of its residents.³⁰¹

A breach of the facility's contract with the resident can also form the basis of a claim for relief for the facility's failure to provide adequate quality of care. Admission agreements rarely include express terms requiring facilities to provide high quality care, but arguably can be held to incorporate implicitly the requirements of state licensing standards, Medicaid standards (for Medicaid beneficiaries), and warranties of habitability provided in state housing laws.³⁰² Many admission contracts disclaim liability for resident safety or the acts of employees following physician orders. These provisions, however, would appear to be unconscionable and contrary to public policy, and the Federal Trade Commission is considering adopting a rule prohibiting such disclaimers.³⁰³

298. 33 Ill. 2d 326, 211 N.E.2d 253 (1965).

299. See Hackler, *Expansion of Health Care Providers' Liability: An Application of Darling to Long-Term Health Care Facilities*, 9 CONN. L. REV. 462 (1977).

300. But see *Stogsdill v. Manor Convalescent Home, Inc.*, 35 Ill. App. 3d 634, 664, 343 N.E.2d 589, 611 (1976); *Darling v. Charleston Community Memorial Hosp.*, 33 Ill. 3d 326, 211 N.E.2d 253 (1965). See also Hackler, *supra* note 299, at 470-71.

301. See *Dunahoo v. Brooks*, 272 Ala. 87, 128 S.E.2d 485 (1961).

302. See *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970); *Steele v. Latimer*, 214 Kan. 329, 521 P.2d 304 (1974); *Pines v. Persson*, 14 Wis. 2d 590, 112 N.W.2d 409 (1961). Implied warranties of fitness and merchantability apply to goods, not services. Regan, *When Nursing Home Patients Complain: The Ombudsman or the Patient Advocate*, 65 GEO. L.J. 691, 714 (1971).

303. The Federal Trade Commission is investigating deceptive and misleading advertising

In addition to asserting breaches of contracts with residents, nursing home patients have been permitted to assert the rights of third party beneficiaries to any contract between the facility and the state,³⁰⁴ such as the Medicaid Provider Agreement,³⁰⁵ which includes all the Medicaid-Medicare Conditions of Participation, including the patients' rights standards.

Beyond contract claims, it is also possible in some states to derive a cause of action directly from state or federal nursing home standards. Some state statutes, such as California's, expressly provide such a private right of action, permitting any person acting for himself or the general public to seek injunctive relief or damages for a facility's continuing violation after a citation has been issued.³⁰⁶ Other statutes provide a much broader private remedy. The New York and West Virginia laws authorize a private right of action for injuries to the rights of any nursing home resident created by a contract or by any state or federal law or regulation.³⁰⁷ These laws provide for compensatory and punitive damages and injunctive relief. They permit the defense that the facility exercised all care reasonably necessary to prevent the injury, but expressly prohibit the defense of exhaustion of administrative remedies. Both statutes also exempt any damage award to Medicaid recipients from consideration as income or assets in determining initial or continuing Medicaid eligibility,³⁰⁸ which is an important consideration in encouraging injured residents to assert their rights. The laws further nullify any oral or written waiver of the right to commence legal action.³⁰⁹ New York's law also provides for attorneys' fees³¹⁰ and prohibits premiums for liability insurance to cover

and business practices by nursing homes, including contractual disclaimers, extra charges for apparently routine items, lack of free choice in obtaining drugs and personal supplies, theft of residents' funds and belongings, and improper accounting for bills. Since the FTC's jurisdiction extends only to commercial aspects of the industry, it is considering issuing a Trade Regulation Rule prohibiting unconscionable contract disclaimers, mandating freedom of choice of suppliers, and requiring disclosure of services for which extra charges will be made, termination policies, and refund practices. Dole, *supra* note 96, at 2.

304. See *Fuzie v. Manor Care, Inc.*, 461 F. Supp. 689 (N.D. Ohio 1977).

305. See *Euresti v. Stenner*, 458 F.2d 1115 (10th Cir. 1972).

306. CAL. HEALTH & SAFETY CODE § 1430 (West Cum. Supp. 1979).

307. N.Y. PUB. HEALTH LAW § 2801-d (McKinney 1977); W. VA. CODE § 16-5C-15(c) (Supp. 1978). The New York law sets a minimum level of damages recoverable in such an action at 25% of the daily Medicaid patient rate.

308. N.Y. PUB. HEALTH LAW § 2801-d(5) (McKinney 1977); W. VA. CODE § 16-5C-15(c) (Supp. 1978).

309. N.Y. PUB. HEALTH LAW § 2801-d(7) (McKinney 1977); W. VA. CODE § 16-5C-15(c) (Supp. 1978).

310. N.Y. PUB. HEALTH LAW § 2801-d(6) (McKinney 1977). See also OHIO REV. CODE ANN. § 3721.17(I) (Page Cum. Supp. 1978).

private action awards from being allowable costs reimbursable to the nursing home under Medicaid.³¹¹

The existence of these statutes creating private rights of action is particularly important in view of conflicting judicial interpretations of whether aggrieved nursing home residents have implied rights of action under the federal Medicaid-Medicare Conditions of Participation or state licensing standards. The Medicaid statute, which generally directs state Medicaid agencies to design their programs to conform to broadly outlined federal policies, has been enforced by beneficiaries of the program without first seeking relief from HEW, the federal agency charged with its general enforcement.³¹² Courts have permitted such direct actions by beneficiaries since the Supreme Court, in *Rosado v. Wyman*,³¹³ expressly held that beneficiaries of the Social Security Act need not seek relief from HEW but can sue offending state agencies directly. In essence, the Court held that there was a private right of action for a beneficiary of the Social Security Act against a state for neglect of its duties under the Act.

Few courts, however, have addressed the question whether there is also a private right of action under the Social Security Act or its regulations against other entities, such as nursing homes, that have express duties under the legislation.³¹⁴ The three reported cases that have thus far raised the issue have reached inconsistent conclusions. In *Berry v. First Healthcare Corp.*,³¹⁵ plaintiffs challenged the nursing home's policy of transferring persons who became eligible for Medicaid after residing in the facility for less than two years. The Federal District Court for the District of New Hampshire held that the plaintiff nursing home residents properly stated a claim under the federal Medicaid regulations regarding a patient's right not to be transferred except under certain circumstances.³¹⁶ The court briefly examined the question whether the Medicaid statute created a private right of action, noting that Congress had not specifically refused to grant such a right. The court also found that since there was no HEW provision permitting plaintiffs to seek administrative review of the nursing home's action, it must permit

311. N.Y. PUB. HEALTH LAW § 2801-d(9) (McKinney 1977).

312. See, e.g., *Hayes v. Stanton*, 512 F.2d 133 (7th Cir. 1975); *Blue v. Craig*, 505 F.2d 830 (4th Cir. 1974); *Schaak v. Schmidt*, 344 F. Supp. 99 (E.D. Wis. 1971); *Triplett v. Cobb*, 331 F. Supp. 652 (D. Miss. 1971); *Wilczynski v. Harder*, 323 F. Supp. 509 (D. Conn. 1971); *Fullington v. Shea*, 320 F. Supp. 500 (D. Colo. 1970), *aff'd* 404 U.S. 963 (1971).

313. 397 U.S. 397 (1970).

314. See, e.g., *Yanez v. Jones*, 361 F. Supp. 701 (N.D. Utah 1973).

315. No. 77-208 (D.N.H., Oct. 26, 1977).

316. *Id.*; see 42 C.F.R. § 405.1121(4) (1978).

judicial review, citing other cases in which private rights of action have been directly implied from federal statutes and the Constitution.³¹⁷ While this analysis might seem simplistic, it is consistent with the treatment of beneficiaries enforcing the Medicaid law against state agencies.

In *Roberson v. Wood*,³¹⁸ the Federal District Court for the Eastern District of Illinois found a private right of action in a suit by Medicaid nursing home residents threatened by transfer. The court followed the tests for implying such a claim set forth by the Supreme Court in *Cort v. Ash*,³¹⁹ a case in which stockholders unsuccessfully attempted to assert a private right of action for damages under a federal election law providing criminal penalties for corporate campaign contributions. The court found that the Medicaid statute was enacted for the particular benefit of nursing home resident plaintiffs, that Congress must implicitly have intended that they could enforce those rights, that the remedy of private enforcement was consistent with the underlying purposes of the Medicaid statute, and that since the program was exclusively federal the remedy was not one traditionally relegated to state law.³²⁰

The *Roberson* court expressly distinguished *Fuzie v. Manor Care, Inc.*,³²¹ in which the Federal District Court for the Northern District of Ohio denied a private right of action on facts identical to those in *Berry*. After a lengthy discussion of the background and purposes of the Medicaid program and the involvement of private nursing homes in the program, the *Fuzie* court held that because defendant nursing home was not acting under color of state law, plaintiff could not state a claim against it under 42 U.S.C. section 1983 or the Constitution.³²²

317. No. 77-208 (D.N.H., Oct. 26, 1977) (citing *Bivens v. Six Unknown Agents*, 403 U.S. 388 (1971); *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Bell v. Hood*, 327 U.S. 678 (1946)).

318. 464 F. Supp. 983 (E.D. Ill. 1979).

319. 422 U.S. 66, 78 (1975).

320. 464 F. Supp. at 983.

321. 461 F. Supp. 689 (N.D. Ohio 1977). This decision was important for establishing federal jurisdiction, see 28 U.S.C. § 1343 (1976), and the right of the prevailing party to seek attorney's fees, see 42 U.S.C. § 1988 (1976). In *Buscho v. Northwest Care Centers, Inc.*, No. A7706.08560 (D. Or., June 22, 1978), a "transfer case" arising out of patients' rights regulations regarding transfers, the court denied the nursing home's motion to dismiss, holding that plaintiff did state a claim under 42 U.S.C. § 1983 (1976). See also *Fried v. Straussman*, 82 Misc.2d 121, 369 N.Y.S.2d 591, *aff'd mem.*, 50 A.D.2d 919, 377 N.Y.S.2d 953 (1975), *rev'd*, 41 N.Y.2d 376, 361 N.E.2d 984, 393 N.Y.S.2d 334 (1977). In *Buscho*, plaintiff also sued the Medicaid and licensing agencies on the ground that the state negligently insisted that the facility correct deficiencies or close in five days. The facility then moved plaintiff's decedent, leading to her death. The court denied the state's motion to dismiss, which had been based on the contention that the Medicaid plan created no duty to plaintiff's decedent or that any duty so created was discretionary.

322. No. C77-265 (N.D. Ohio, July 7, 1977), *reprinted in* [1977] *MEDICARE & MEDICAID GUIDE* (CCH) ¶ 28,694. Plaintiff in *Buscho v. Northwest Care Center, Inc.*, No. A7706.08560 (D. Or., June 22, 1978) alleged that the State of Oregon had required that the facility move residents

that the Social Security Act provided no implied right of action for enforcement of the federal nursing home standards, and that a private right of action under the Medicaid nursing home regulations met none of the tests enunciated in *Cort v. Ash* for implying a private right of action.³²³ The *Fuzie* court found, however, that plaintiff had stated a claim for breach of contract because she was a third party beneficiary of the provider agreement, which incorporated the federal standards, including the transfer limitations that underlay her claim, between the state Medicaid agency and the nursing home defendant.³²⁴ The court

needing a higher level of nursing care, increase staff or close the nursing home. See also *Stitt v. Manor Care, Inc.*, No. C78-630 (N.D. Ohio, Oct. 24, 1978), reprinted in [1978] *MEDICARE & MEDICAID GUIDE* (CCH) ¶ 29,409.

323. The first test in *Cort* is whether the plaintiff is a member of the class for whose benefit the statute was enacted. 422 U.S. at 78. The *Fuzie* court, while conceding that the Medicaid law and regulations seem to indicate that Medicaid beneficiaries are "among the class of persons for whose benefit this legislation was enacted and the regulations promulgated," inexplicably concluded that plaintiffs did not satisfy the test because they did not have an absolute right not to be transferred. For instance, residents could not prevent transfer if the nursing home's provider agreement was cancelled by the state. No. C77-265 (N.D. Ohio, July 7, 1977), reprinted in [1977] *MEDICARE & MEDICAID GUIDE* (CCH) ¶ 28,694. Whether an absolute right exists under the federal law should make no difference in determining whether the statute creates a private cause of action for its enforcement. That concern relates only to ultimate remedy.

The second *Cort* test is whether any legislative pronouncement explicitly or implicitly suggests the intent to create or deny a private cause of action. 422 U.S. at 78. In reaching its conclusion, the *Fuzie* court pointed to the requirements for judicial review of administrative decisions under Medicare, 42 U.S.C. § 1395ff(c) (1976), and noted the absence of any parallel in the Medicaid statute. What the court failed to note is the distinction between Medicare, an exclusively federal program in which all terms of eligibility, benefits and appeal systems are specifically described, and Medicaid, in which states are given discretion to develop programs under federal guidelines. The failure to spell out judicial review of Medicaid claims for beneficiaries does not, therefore, prove that there is no private right of action intended under the Medicaid statute. More than ten years of experience under Medicaid, during which courts have permitted beneficiaries to sue states for failures to follow federal law, see note 312 *supra*, and several subsequent amendments to the Medicaid statute, in which Congress has implicitly acquiesced in these judicial decisions, support the better view that there is no legislative intent to deny a private right of action under the Medicaid statute.

While it is true that states may have the primary enforcement role under Medicaid, their failure to monitor nursing home compliance, which has been recognized by Congress, S. REP. NO. 404, 89th Cong., 1st Sess. 76 (1965), reinforces the need for a right of the beneficiary to pursue the enforcement, especially when he or she has no right to trigger administrative enforcement at either the federal or state level. See, e.g., *Rosado v. Wyman*, 397 U.S. 397 (1970). In *Cort v. Ash*, the Supreme Court held that stockholder derivative suits are such cases.

324. While breach of contract claims are certainly an area of state law, it would have been disingenuous for the court to hold that when the very contract term at issue is one created by federal law the federal courts should not permit its enforcement in a federal forum. The final twist to the convoluted logic of this case came, however, when the court determined that plaintiff had pleaded a contract claim as a third party beneficiary, which was proper under state law, and permitted plaintiff to remain in federal court by asserting jurisdiction over the pendent state claim and the pendent party, despite the lack of a federal claim presumably required for pendent jurisdiction. To achieve this objective the court unconvincingly distinguished *Aldinger v. Howard*, 427 U.S. 1 (1976), in which the Supreme Court had refused to extend pendent party jurisdiction to parties over whom there was no independent basis for federal jurisdiction.

then permitted plaintiff to proceed on this contract claim in her federal action.

The finding of the *Fuzie* court that defendant nursing home was not acting under color of state law is understandable in view of recent Supreme Court decisions requiring a high degree of state involvement in the actual challenged policy or action for such a finding.³²⁵ Mere government subsidy and regulation are not enough to turn private action into state action, although active participation in challenged conduct (such as requiring the transfer contrary to the federal standard) should constitute sufficient state involvement. The approach of the *Fuzie* case, however, would make it impossible for most beneficiaries deprived of Medicaid statutory rights by providers to enforce them, since nursing homes are among the few Medicaid providers that execute annual contracts with state agencies and the vast majority of health care providers, including hospitals and physicians, do not do so.³²⁶

Even if courts are willing to imply private rights of action, private enforcement of quality of care in long-term care institutions is no greater than the underlying quality standards in federal certification rules or state licensing regulations. Because of the significant weaknesses of these standards in assuring quality of care,³²⁷ the right of residents to protect themselves through such litigation is correspondingly limited.

E. Public Involvement in Nursing Home Quality of Care Enforcement

While state and federal agencies should better perform their responsibilities to establish and enforce standards to assure quality of care for nursing home residents, and while private actions may enhance the right to such care, any regulatory or judicial action is insufficient to fulfill this task completely. The public should be actively involved in monitoring the care in nursing homes as well as the functioning of the enforcement agencies. Because there is no real constituency supporting

325. See, e.g., *Jackson v. Metropolitan Edison Co.*, 419 U.S. 435, 451 (1974).

326. In *Yanez v. Jones*, 361 F. Supp. 701 (N.D. Utah 1972), plaintiffs challenged private physicians' refusal to follow a Medicaid regulation, 42 C.F.R. § 447.15 (1978), which required them to accept Medicaid rates as full payment and prohibited them from charging to their Medicaid patients any additional sums. The court permitted the action to proceed against the state Medicaid agency, which was required by the regulation to enforce the provision against all providers, but declined to permit an action directly against the offending physician, despite the apparently contrary precedent in the Tenth Circuit of *Eureste v. Stenner*, 458 F.2d 1115 (10th Cir. 1972).

327. See notes 79-95 and accompanying text *supra*.

agency enforcement efforts, licensing agencies are subject to constant industry pressure without the counterpressure—or reinforcement—from nursing home reform interests representing the community in general and residents in particular. The Nursing Home Ombudsmen funded in each state by the federal Administration on Aging³²⁸ are ill-suited for this task since they are usually state agencies rather than community groups, which are less subject to industry pressure.³²⁹ Without a strong, vocal constituency representing nursing home residents' interests, even the best-intentioned regulators and policymakers are worn down and enervated by constant industry pressure to weaken enforcement efforts.

Community interest and concern is perhaps the single most important reason that small, rural nursing homes (which may not comply fully with safety or fire standards) often have the best reputations for providing a high quality of care and life to residents. When the residents and their families are neighbors and acquaintances of the nursing home owners, operators and staff, and when the community actively supports and encourages the facility in efforts to provide good care, residents report a high degree of satisfaction with services. As one commentator has noted:

To make the point that institutions do a better job when outsiders are constantly coming in and out is *not* to suggest that they maintain their standards only for show. Rather, it is to recognize that we all depend on the interest and appreciation of other people to keep our morale and the quality of our work high. Dressing for dinner in the desert is not a standard most of us could keep to. We tidy the house for the visit of friends because of standards they and we share, and because we want them to appreciate our house as we do.³³⁰

Community groups supporting nursing home residents have developed in some parts of the country. Organizations such as Citizens for Better Care in Detroit,³³¹ Friends of Nursing Home Patients in Chapel Hill,

328. 42 U.S.C.A. § 3027 (a)(12) (West Cum. Supp. 1979). Several states have also adopted ombudsmen legislation. *See, e.g.*, MD. ANN. CODE art. 43, § 565(c), art. 70B, § 4(a) (1978); N.J. STAT. ANN. § 52:27G-1-16 (West Cum. Supp. 1978).

329. The Colorado Nursing Home Ombudsman was located in the office of the Denver Legal Aid Society for several years, but because of its strong pro-resident, often controversial, positions it was moved by the state Medicaid Agency to the State Office on Aging. *See generally* Regan, *supra* note 302, at 698, 704.

330. Barney, *Community Presence as a Key to Quality of Life in Nursing Homes*, 64 AM. J. PUB. HEALTH 265 (1974).

331. For information about Citizens for Better Care, write: 163 Madison, Detroit, Mich. 48226 (313-962-5571).

North Carolina,³³² Save the Village Nursing Home in New York City,³³³ and the National Citizens' Coalition for Nursing Home Reform³³⁴ have been effective advocates for nursing home patients' rights at the local, state and national levels. Many more such groups must be established to assure active, regular and continuing public involvement in nursing home activities.

Meaningful public involvement in nursing home quality monitoring and enforcement can take the form of broad scale legislative and administrative advocacy, as well as concern with the care provided by a single facility or the appropriateness of placing an individual in a given nursing home. This public participation at all levels cannot occur unless adequate information is made available to the public about conditions in facilities and facility compliance with licensing and Medicare-Medicaid standards. The federal Medicaid and Medicare statutes, as amended in 1972, require public disclosure of the certification survey reports;³³⁵ these provisions were enacted as the result of successful litigation in various states requiring disclosure under the federal Freedom of Information Act.³³⁶ Since the federal law only requires that the deficiency lists (and facility responses) be made available by the certification agency, the Medicaid agency and the local office of the Social Security Administration,³³⁷ public access to the reports under this law is somewhat limited. Some state laws, however, expressly authorize such disclosure of licensing inspection reports.³³⁸

A few states now require that facilities either post citations or deficiency lists they receive,³³⁹ make the information available to any prospective resident upon request,³⁴⁰ or publish the citations.³⁴¹ The requirement of posting notices of violation can certainly serve as a de-

332. For information about Friends of Nursing Home Patients, write: 207 Wilson Court, Chapel Hill, N.C. 27514 (919-967-6198).

333. For information about Save the Village Nursing Home, which assumed ownership of a facility in Greenwich Village for which the state had obtained appointment of a receiver, write: Friends and Relatives of Institutionalized Aged, 400 E. 26th Street, N.Y., N.Y. 10010.

334. For more information, write: 1424 16th Street, N.W., Washington, D.C. 20036.

335. 42 U.S.C. §§ 1395aa(a), 1396(a)(27) (1976).

336. See generally Regan, *Quality Assurance Systems in Nursing Homes*, 53 J. URB. L. REV. 153, 196-98 (1975).

337. 42 C.F.R. § 431.115(f) (1978).

338. See, e.g., W. VA. CODE § 16-5C-16 (Supp. 1978).

339. See, e.g., CAL. HEALTH & SAFETY CODE § 1429 (West Cum. Supp. 1979); KAN. STAT. § 39-935 (Cum. Supp. 1978); MINN. STAT. ANN. § 144A-10(3) (West Cum. Supp. 1978).

340. See, e.g., WIS. STAT. ANN. § 50.04(3)(c) (West Cum. Supp. 1978).

341. Kansas law requires publication in a newspaper of general circulation in the county in which the facility is located. KAN. STAT. § 39-946(a) (Cum. Supp. 1978). Iowa law requires the state licensing agency to publish annually a list of the facilities with and without citations and the

terrent to facility violations of licensing standards and as a means of informing the public of the relative status of the nursing home. One must ponder the effect of such public deficiency notices upon the psychological and emotional well-being of the residents in the facility. The discomfort of knowing one resides in a substandard facility, however, is probably outweighed by the need to correct violations and permit public knowledge.

Several states are experimenting with approaches to encourage greater public and community involvement in nursing home quality assurance. California and Iowa permit any person to request a facility inspection upon written complaint and protect the identity of the complainant from disclosure.³⁴² The complainant may, however, accompany the inspector if he or she wishes.³⁴³ Although this authorization of citizen participation in nursing home surveys is rarely used in California,³⁴⁴ it could be an important source of community involvement.

Access of resident advocates and interested members of the public to nursing homes has often been a source of difficulty.³⁴⁵ Cases authorizing the public to enter private property imbued with a public purpose have provided some relief for this problem,³⁴⁶ but subsequent pronouncements from the Supreme Court have characterized such apparently public property as shopping centers as private and have substantially undercut rights of public access.³⁴⁷ Some state laws expressly provide the right of access to facilities by "members of recognized community organizations and community legal services programs,"³⁴⁸ and courts have enforced these provisions.³⁴⁹

Some states have established various types of community advisory

actions taken on each citation. IOWA CODE ANN. § 135C.38 (West Cum. Supp. 1978). *See also* CAL. HEALTH & SAFETY CODE § 1420 (West Cum. Supp. 1979).

342. CAL. HEALTH & SAFETY CODE § 1419 (West Cum. Supp. 1979). IOWA CODE ANN. § 135C.38 (West Cum. Supp. 1978).

343. CAL. HEALTH & SAFETY CODE § 1420 (West Cum. Supp. 1979); IOWA CODE ANN. § 135C.38(2) (West Cum. Supp. 1978).

344. Interview with Bill Smith, Chief of Health Services Section, Licensing and Certification Division, California Dep't of Health (Dec. 23, 1977).

345. *See* The Health Law Project, *Legal Problems Inherent in Organizing Nursing Home Occupants*, 6 CLEARINGHOUSE REV. 203, 203-06 (1972).

346. *See, e.g.*, *Food Employees Local 590 v. Logan Valley Plaza, Inc.*, 391 U.S. 308 (1968); *Marsh v. Alabama*, 326 U.S. 308 (1945).

347. *See* *Lloyd Corp. v. Tanner*, 407 U.S. 551 (1972).

348. *See, e.g.*, W. VA. CODE § 16-5C-5(b)(1) (Cum. Supp. 1978). *See also* OHIO REV. STAT. ANN. § 3721.14(D) (Page Cum. Supp. 1978); MASSACHUSETTS ATTORNEY GENERAL, RULES AND REGULATIONS RELATING TO NURSING HOMES, rule 4 (1975).

349. *Commonwealth v. Q.T. Service, Inc.*, No. 78-564 (Mass. Sup. Ct., Jan. 31, 1978) (order granting temporary restraining order).

boards or committees to provide oversight and input into the nursing home enforcement process. Minnesota, for example, has a fifteen-member state Nursing Home Advisory Council to the Department of Health, which has representatives of residents and the public as members, although it is dominated by persons who either control nursing homes or provide services to them.³⁵⁰

In Iowa, Care Review Committees, composed of disinterested citizens appointed by local health planning agencies, must exist for each nursing home in the state. The committees' function is to "represent the rights" of nursing home residents, process complaints, and "consider" their personal and social needs to determine if they are being met.³⁵¹ The committee members may not, however, examine medical records or medical needs.³⁵² The committees, which have been functioning for about two years, have been criticized for ineffectiveness, partially due to lack of training. Out of 4000 nursing home complaints submitted to the state Health Department in 1977, only twelve had come through the Care Review Committees, although they are statutorily responsible for accepting and processing complaints.³⁵³ Furthermore, the committees have no enforcement authority except to report to the Department for follow-up and possible citation.

North Carolina has adopted similar legislation, requiring county-wide community advisory committees for nursing homes appointed by the county commissioners and nursing home administrators.³⁵⁴ Each committee has the responsibility to visit each home in the county quarterly, apprise itself of conditions in the home, and "work for the best interests" of the residents, including representing them in grievances with the facility.³⁵⁵ While there is no experience yet with these committees, their authority seems broader than that of the advisory committees in Iowa, and they may provide more effective community involvement in quality of care enforcement.

These diverse experiments to involve the public in nursing home affairs and quality of care enforcement are critical both to an effective

350. MINN. STAT. ANN. § 144A.17 (West Cum. Supp. 1978).

351. IOWA CODE ANN. § 135C.25 (West Cum. Supp. 1978); IOWA DEP'T OF HEALTH, RULES AND REGULATIONS FOR SKILLED NURSING FACILITIES § 470-59.32 (1978).

352. IOWA DEP'T OF HEALTH, RULES AND REGULATIONS FOR SKILLED NURSING FACILITIES § 470-59.32(3)(b) (1978).

353. Interview with Randi Youells, Staff Attorney, Legal Services Corporation of Iowa, in Des Moines, Iowa (Nov. 14, 1978).

354. N.C. GEN. STAT. § 130-9(e)(7) (Cum. Supp. 1978).

355. *Id.*

and vital state enforcement system and to the continuous provision of a high quality of care in the facilities. Without active community support and prodding, state licensing agencies languish and fail to fulfill their public responsibilities. Cooperation and, when necessary, healthy conflict can maintain an appropriate level of energy and dedication in the state agency. Even without such coordination, greater public knowledge about and concern for nursing homes and their residents can provide more informed placement decisions, more meaningful advocacy to facilities on behalf of residents, and a more open atmosphere in nursing homes that is bound to provide a higher quality of resident services.³⁵⁶ Furthermore, the better the community understands the problems and needs of the elderly, the more likely it will be to propose, develop and fund noninstitutional alternatives and to provide a generally more dignified and humane approach to long-term health care services. The ultimate result of public knowledge and scrutiny should be a significant improvement in the quality of long-term care.

IV. COSTS OF IMPROVED NURSING HOME QUALITY ENFORCEMENT

In view of the general theme of this symposium, a legitimate question to ask is what would be the costs of the various proposed solutions to quality of care enforcement in nursing homes. It has been alleged that the costs of legal enforcement actions and facility appeals under the California citation system are extreme.³⁵⁷ Similarly, imposition of receiverships,³⁵⁸ especially those requiring additional outlays of state funds to correct deficiencies,³⁵⁹ could be considerable. On the other hand, shifting the approach of the Medicare-Medicaid Conditions of Participation to a resident focus, using a resident assessment instrument, could save resources. By surveying facilities and residents on a sample basis, using computers, and eliminating surveyor and facility time now allotted to "paper compliance" with the extant structural standards, a revitalized system could actually cost less than the current en-

356. See generally Barney, *supra* note 330.

357. See note 204 *supra*.

358. A group of economists analyzing the impact of housing code enforcement on rents concluded that of the three enforcement remedies studied (repair and deduct, withholding rent and receivership), receivership had a statistically significant impact on rent increases. Hirsch, Hirsch & Margolis, *Regression Analysis of the Effects of Habitability Laws upon Rent: An Empirical Observation on the Ackerman-Komesar Debate*, 63 CALIF. L. REV. 1098, 1129 (1975). The authors examined only the cost increases for the consumers of housing, not other costs associated with enforcement of housing codes, but the analogy to enforcing nursing home quality of care should be considered.

359. See notes 243-45 *supra*.

forcement system. The development of noninstitutional community-based resources for long-term care and the diversion of the current Medicaid emphasis from nursing homes to these more appropriate services, could also be more economical than paying for nursing home services alone, although whether cost savings would result in each case would depend upon the precise mix of services required. The National Institute on Aging has suggested that concentrating on medical intervention for the elderly instead of socioeconomic considerations is more costly to society in both fiscal and human terms.³⁶⁰

V. CONCLUSION

The history of nursing home services in the United States and government regulation of their quality has been shameful. After many years of recognized abuse and failure, new methods of enforcing the quality of care in nursing homes by revision of standards, incentive reimbursement and more varied licensing compliance remedies are now being adopted. Early indications of their effectiveness provide some hope for success. As the number of elderly needing long-term health care services increases exponentially and the costs of nursing home care skyrocket, we owe the older generation and the taxpayer the assurance that care is delivered in a responsible, high quality, humane and cost-efficient manner. The effectiveness of government regulation of health care has not been highly regarded by the public. Nursing home surveyors are easily demoralized by industry pressure and public apathy. No merely cosmetic or organizational changes will assist these regulators in performing their public duties more creatively. The regulatory system must be revitalized and reconstructed to examine more closely the care delivered to nursing home residents, and the public must be involved in the ongoing conduct of local nursing care facilities to encourage delivery of good care and to support regulatory efforts. In light of the frequent attacks on the costly and ineffective nature of regulation, the development in the next decade of a regulatory system that assures high quality nursing home care will be a major test of the potential of government regulation in a field in which success is critical to the quality of human life.

360. See Butler, *supra* note 1, at 1797.

CAPITAL FINANCING FOR HOSPITALS: THE NEW YORK EXPERIENCE

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The state and federal governments have become increasingly concerned with the rapid escalation of hospital capital expenditures because of the implications of such expenditures for the type of health services provided, the number of hospital beds available and the costs of operating hospitals.¹ The Congressional Budget Office estimated that hospital capital expenditures increased by an average of 15.5 percent per annum between 1970 and 1975 and projected that the expenditures, if unchecked, would reach \$8.0 billion in 1978 and \$14.4 billion in 1982.² During the period from 1970 to 1975, the number of hospital beds increased by an average of 2.3 percent per annum resulting in an increase of almost 100,000 beds and driving the number of hospital beds from 4.2 per 1,000 population to 4.5 per 1,000.³ This accounted for a portion of the increase in capital expenditures; inflation and increased assets per bed accounted for the remainder.

Nevertheless, the state and federal governments have been actively involved in promoting capital expenditures through a variety of mechanisms, including the federal Hill-Burton Program, federal hospital mortgage insurance, cost-based reimbursement covering both depreciation and interest under Medicare and Medicaid, and tax-exempt bond financing by state and local governments or entities authorized by those governments. Moreover, the state and federal governments have mandated extensive capital construction by increasing the stringency of life-

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1. See, e.g., INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES, CONTROLLING THE SUPPLY OF HOSPITAL BEDS (1976); W. MCCLURE, REDUCING EXCESS HOSPITAL CAPACITY (1976); Inglehart, *A Field Day for Goldilocks*, 26 NAT'L J. 1060 (1978); Inglehart, *Capital Deformation*, 40 NAT'L J. 1699 (1977); Inglehart, *Stemming Hospital Growth—The Flip Side of Carter's Cost Control Plan*, 23 NAT'L J. 848 (1977).

2. CONGRESSIONAL BUDGET OFFICE, 95th CONG., 1st SESS., HOSPITAL COST CONTAINMENT ACT OF 1977: AN ANALYSIS OF THE ADMINISTRATION'S PROPOSAL 13 (Comm. Print 1977).

3. Somers & Somers, *A Proposed Framework for Health and Health Policy*, 14 INQUIRY 131, 135 (1977).

safety codes and other structural requirements.⁴

Proposals for containing the escalation of hospital capital expenditures have ranged from a nationwide cap on annual capital expenditures,⁵ to a moratorium on all hospital capital expenditures,⁶ to restrictions on tax-exempt financing for hospitals.⁷ Barring an outright moratorium, federal and state governments must more effectively integrate their financing, planning and cost containment strategies by targeting capital construction toward needed services and underserved areas and by assuring that projects undertaken are cost effective.

In order to explore more fully the public policy implications of hospital financing, this article reviews the government financing mechanisms available nationwide and then focuses on the experience in the State of New York. New York provides an interesting case study for two reasons. First, government financing programs for promoting hospital construction and renovation have been used extensively. Second, state officials have closely scrutinized and reevaluated the appropriate role of tax-exempt financing—for housing, mental health, colleges, universities, nursing homes and hospitals—as a result of the serious difficulties the state encountered in the financial markets in 1975 and 1976. The New York experience thus provides useful insights for other states confronting financial constraints.

I. THE EXISTING NATIONWIDE FINANCING MECHANISMS

The two major government financing programs active today—federal insurance on hospital mortgages and tax-exempt bonds issued by

4. The increasingly restrictive conditions of participation for the Medicare program are one example. See also Wing & Sifton, *Constitutional Authority for Extending Federal Control Over the Delivery of Health Care*, this Symposium.

5. This approach was incorporated in Title II of the Carter Administration's proposed Hospital Cost Containment Act of 1977, S. 1391, H.R. 6575, 95th Cong., 1st Sess. (1977).

6. See, e.g., V. FUCHS, *WHO SHALL LIVE?* 104 (1974).

7. Representative Dan Rostenkowski, Chairman, Subcommittee on Health, Committee on Ways and Means, United States House of Representatives, stated:

[A]t a time when virtually all health economists believe that there must be more restraint exercised in the development of new facilities, tax-exempt financing authorized through Section 103 of the tax code has become the largest hospital construction program in this country.

... The very existence of easily accessible, no-risk, tax-exempt bonds is an inducement to build. Should not the government reevaluate its tax policy which has become the fiscal basis for much new construction in the hospital industry?

Health Priorities: Where Should the Nation Be Going?, A National Journal Conference Proceedings: The Carter Administration, Congress and Health Policy, Washington, D.C., (May 22-23, 1978).

state and local governmental entities—both involve debt financing⁸ secured by a mortgage or a lease. This use of debt is indicative of the trend in hospital financing over the last decade away from philanthropy and government grants.⁹ Indeed, it is now the fastest growing source of hospital capital funds. Although estimates vary, its rapid rise is extensively documented. The American Hospital Association calculates that debt financing's relative position as a source of capital funds for hospitals has increased from 39.5 percent for projects completed in 1968 to 67.9 percent for projects begun in 1976.¹⁰ These figures include both government-related and private lending sources.

Federal and state governments have assisted and reinforced the trend toward debt financing in two ways. First, Medicare and Medicaid—major sources of revenue for hospitals—have reimbursed hospitals for interest and other capital costs.¹¹ Second, the federal and state governments have actually provided sources of debt financing. Hospital construction financed through federal insurance programs or tax-exempt bond proceeds increased from a negligible share of total funding in the late 1960s to 15.2 percent of total hospital construction for insured mortgages and 34.6 percent for tax-exempt bond proceeds in 1976.¹²

8. The federal Hill-Burton program no longer receives appropriations and has been effectively replaced by the resource development program authorized under the National Health Planning and Resources Development Act of 1974, 42 U.S.C. § 3001 (1976); see Wing & Craige, *Health Care Regulation: Dilemma of a Partially Developed Public Policy*, this Symposium, at text accompanying notes 184-85.

9. Irwin Wolkstein has identified three stages in the history of hospital capital financing. Originally, philanthropy was the primary provider of capital funds. Next, after a hiatus in hospital construction during the Great Depression and World War II, government grants-in-aid played the predominant role. Finally, since the establishment of Medicare and Medicaid in the late 1960's, internally generated funds—primarily from third-party payors—have become the major source by enabling hospitals to accumulate reserves and/or support debt service requirements. Wolkstein, *The Impact of Legislation on Capital Development for Health Facilities*, in G. MACLEOD & M. PERLMAN, *HEALTH CARE CAPITAL: COMPETITION AND CONTROL* 7 (1976).

10. Lightle, *'70s See New Approaches to Capital Financing for Hospitals*, 52 HOSPITALS 131 (1978).

11. See Wolkstein, *supra* note 9, at 21-25. In describing the effect of the Medicare and Medicaid program, Lightle commented that "[t]he reimbursement system itself created incentives for debt financing. By permitting depreciation and interest as allowable expenses, the reimbursement system established a mechanism for hospitals to use future revenues to finance capital needs." Lightle, *supra* note 10, at 135.

12. ICF, INC., *TRENDS IN HOSPITAL CONSTRUCTION AND USE OF FEDERAL SUBSIDIES* 14, 31-32 (Phase III Report, Policy Implications, submitted to Health Resources Administration, Dep't HEW, contract no. HRA-230-77-0083, 1978). Tax-exempt financing increased its share from 22.5% in 1973 to 34.6% in 1976; insured mortgages maintained a relatively constant percentage. The figures cited in another study, BOOZ, ALLEN & HAMILTON, *EVALUATION OF FUTURE HOSPITAL CAPITALIZATION* (1978), are somewhat different, but identify a similar trend. Specifically, they indicate that the share of construction expenditures funded by all debt issues has in-

A. Federal Insurance

The federal government lends its credit to hospitals by providing insurance for mortgages securing loans made to hospitals by traditional, private-sector lenders. This insurance is made available to private nonprofit and proprietary acute care hospitals through the Federal Housing Administration (FHA) pursuant to the provisions of Section 242 of Title II of the Housing and Urban Development Act.¹³ The Department of Housing and Urban Development (HUD) regulates the financial aspects of the program, in many cases in conjunction with FHA's housing and other insurance programs. Many of the financing provisions are the same for several programs; for example, the maximum allowable interest rate was set, as of May 1979, at 10 percent per annum for certain FHA loan insurance programs, including its hospital mortgage program, and for all single family mortgage programs.¹⁴ Similarly, the insurance premium paid by a borrower is .5 percent per annum for all FHA insurance programs.¹⁵

HUD delegates the programmatic aspects of the FHA 242 program to the Department of Health, Education, and Welfare (HEW) through a formal agreement.¹⁶ HEW's activities include reviewing applications, monitoring during the construction period, and determining financial feasibility. The criteria for financing have been established to

creased from 58% in 1973 to 78% in 1977, and that the share allocated to tax-exempt bonds has increased from 25% to 45% over the same period.

13. The program was amended in 1968 to allow mortgage insurance for hospitals, but only for private nonprofit, acute care hospitals. P.L. 90-448, § 1501, 82 Stat. 599 (1968) (codified at 12 U.S.C. § 1715z-7 (1976)). Proprietary hospitals were added to the program in 1970. P.L. 91-609, § 110(a), 84 Stat. 1770 (1970) (codified at 12 U.S.C. § 1715 (1976)). The program is designed for hospital projects requiring construction and renovation rather than merely refinancing of existing indebtedness. See 42 C.F.R. §§ 242.21, .93 (1977). The Housing and Community Development Amendments of 1978, 42 U.S.C. § 1715n (Supp. I 1978), did, however, authorize insurance for entire refinancings of hospitals under another HUD program.

14. Memorandum from L. Simons, Assistant Secretary, Dep't HUD, to all approved mortgagees (April 23, 1979) (copy on file in the office of the *North Carolina Law Review*).

15. In exchange for the insurance, the hospitals pay the FHA an application fee and a commitment fee (together amounting to \$3 per thousand) and, in some cases, an inspection fee (\$5 per thousand). 24 C.F.R. §§ 242.3, .7, .9 (1977). They also pay an annual insurance premium of 0.5% of the outstanding mortgage amount. *Id.* § 207.252(a). In addition, the mortgagee may collect an initial service charge of 2% of the original mortgage amount. *Id.* § 242.19. The term of the mortgage is limited to 25 years. *Id.* § 242.35.

16. DEP'T HEW & DEP'T HUD, MEMORANDUM OF AGREEMENT, SECTION 242, NATIONAL HOUSING ACT, AS AMENDED (1978). This superseded an earlier agreement signed in January 1968 and amended in May 1971. *Id.* The 1978 agreement incorporated the National Guidelines for Health Planning (no more than four short-stay conforming beds per 1,000 population and a community-wide occupancy rate in excess of 80%), 42 C.F.R. § 121 (1978). The Secretary of HUD required that these Guidelines be adopted in final form prior to entering into an agreement containing them. See Letter from Patricia Roberts Harris, Secretary of HUD, to Joseph Califano, Secretary of HEW (July 25, 1978) (copy on file in the office of the *North Carolina Law Review*).

avoid, to the extent possible, defaults that could result in claims against the insurance. The loan amount is limited to 90 percent of the estimated replacement value of the project or 90 percent of the cost of development, whichever is lower.¹⁷ As a result, the mortgage is always backed by a facility that is estimated to be of greater value than the loan amount, although it may not have a greater actual market value. Furthermore, prior to approving a loan, HEW must determine that the project is financially feasible based on reasonable assumptions regarding future events.¹⁸ Finally, there must be a demonstrated need in the community for the services to be provided by the hospital as evidenced by the review and approval of state and local health planning agencies.¹⁹ In setting priorities for financing among eligible projects, however, HEW has not worked closely with these agencies.

The left side of Diagram 1 illustrates the security for an investor in an FHA 242 insured hospital. The investor or mortgagee initially relies upon the hospital's agreement to pay debt service and then upon the pledge of the gross revenues of the hospital.²⁰ The additional security accruing to an investor in an FHA 242 mortgage is illustrated by comparing the position of such an investor after a project has defaulted with that of an investor in a similar, but uninsured mortgage.²¹ When the uninsured project's revenues proved to be insufficient to pay debt service, the investor would foreclose on the mortgage and force a sale. With a first lien, the investor would be entitled to priority in distribution of foreclosure sale proceeds. Yet, it is unlikely that a forced sale would yield an amount even approaching the replacement value of the facility and, therefore, unlikely that the investor would recoup the amount of the outstanding mortgage. Moreover, a significant delay would inevitably be involved in realizing any recovery.

17. 24 C.F.R. §§ 242.27, .29(c) (1977). This provision applies to the construction of new projects. The maximum mortgage amount for a rehabilitation project depends upon how the original property is held, and whether there is an outstanding mortgage. *Id.* § 242.29.

18. HEALTH RESOURCES ADMINISTRATION, DEP'T HEW, HEALTH CARE FACILITIES LOAN PROGRAM: POLICY AND PROCEDURES MANUAL 60-70 (1976). In addition, the New York Regional Office published more detailed requirements for financial feasibility studies. DIVISION OF RESOURCES DEVELOPMENT, PHS REGIONAL OFFICE II, HEALTH CARE FACILITIES HANDBOOK: FINANCIAL FEASIBILITY REVIEW AND LOAN MONITORING PROCEDURES 11-20 (1977).

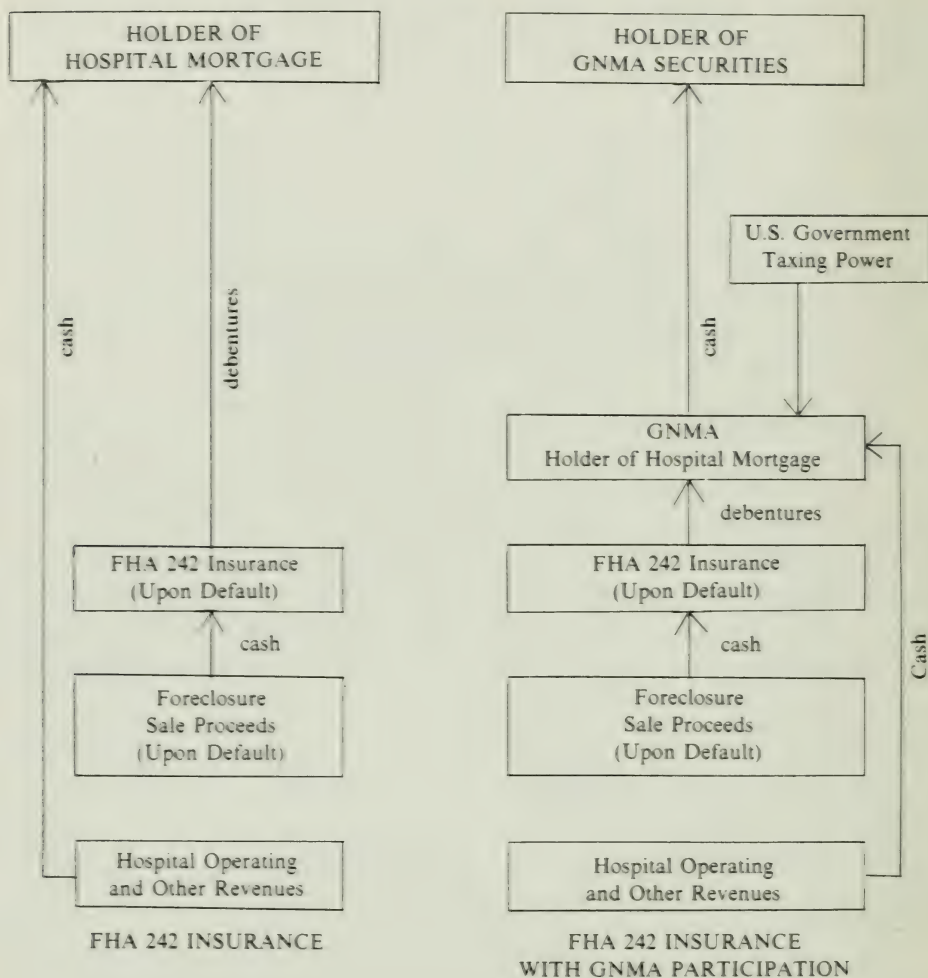
19. 24 C.F.R. § 242.5 (1978). *But see generally* Schonbrun, *Making Certificate of Need Work*, this Symposium.

20. The pledge of revenues can take two forms—all unrestricted revenues ("gross revenues") or unrestricted revenues after payment of operating costs ("net revenues"). Projects benefitting from the FHA 242 program pledge their gross revenues. This device is similar to the traditional "assignment of rents" taken by the mortgage lender on a commercial or residential rental project.

21. The mortgage would be similar in that it constituted a first mortgage lien and was in an amount close to 90% of the replacement value of the project.

DIAGRAM I

FHA 242 INSURED MORTGAGE FINANCING: STRUCTURE OF SECURITY



When FHA 242 insurance is available, however, the investor avoids both the uncertainties of valuation of the property and the delays of a sale. Upon default, the investor in most cases either assigns the mortgage or conveys the title (which it has acquired through foreclosure or a deed in lieu of foreclosure) to FHA and collects on the insurance an amount equal to the outstanding principal balance of the mortgage.²² When a claim is made, the insurance proceeds are not

22. 24 C.F.R. § 207.258 (1977). In certain very limited cases the mortgagee may choose not

paid in cash but in debentures, a form of registered U.S. Treasury bond. The interest rate on the debentures is set at the time the mortgage is issued and is usually lower than the interest rate on the mortgage. For mortgages entered into on or after January 1, 1979, the debentures are for a term of twenty years and pay an interest rate of eight percent per annum with full payment of principal at the expiration of the twenty years regardless of the term and interest rate of the mortgage loan.²³ (FHA can choose to pay in cash, but historically has chosen not to for the FHA 242 program.) In almost all cases, this form of payment means that the investor does not receive full return on the investment. The interest rate is lower on the debentures than on the original mortgage and will not yield the full value of the mortgage. Similarly, the investor is likely to incur a loss if he elects to sell the debentures for cash since the relatively low interest rate usually requires trading at a discount.

In order to eliminate the risk of investors losing on their investments, and thereby to increase the number of investors interested in the mortgages, the Government National Mortgage Association (GNMA), an organization created to improve liquidity in the market, is often interposed between the mortgage holder and the FHA 242 insurance.²⁴ Under this arrangement, illustrated on the right hand side of Diagram 1, the FHA insured mortgage is pledged to GNMA as backing for its own securities, and the original levels of security then inure to GNMA. The original mortgagee continues to make collections and service the mortgage. If a project defaults, GNMA collects on the FHA 242 insurance, and FHA is responsible for foreclosure. The investor holds GNMA securities and continues to receive full payment in cash whether or not the hospital itself makes required payments. Since GNMA securities are ultimately backed by federal government appropriations, investors face almost no risk of losing principal or interest payments and hold a readily marketable security. Therefore, they are more willing to invest in FHA 242 projects that are combined with GNMA securities than in FHA 242 projects alone.

to call upon the insurance but to foreclose directly and retain the sale proceeds. (This option is not illustrated in Diagram 1.)

23. 24 C.F.R. § 207.259 (1977), *as amended by* 44 Fed. Reg. 23516 (1979).

24. In describing the origin of the GNMA, the Housing and Development Reporter states: "The Government National Mortgage Association . . . provides a secondary market for certain mortgages which would not be well received in the private secondary market. It also provides a source of secondary market financing for other types of mortgages in periods of tight credit." [1979] 7 HOUS. & DEV. REP. (BNA) 81.

As Table 1 indicates, from 1969, when the FHA 242 program began, through September 1977, hospital mortgages were insured for approximately \$1.7 billion, an average of over \$12 million per project.²⁵ There was, however, no consistent trend over that period of time in the number of projects insured each year, the average dollar value of the projects or the total value of insurance issued each year.²⁶

TABLE 1²⁷
FHA-242 MORTGAGE INSURANCE VALUE AND
TOTAL PROJECT VALUE BY YEAR OF APPROVAL, 1969-1977

Year of Approval	Number of Projects	FHA Mortgage Insurance Value	Total Project Value	Average Project Value
		(\$ millions)	(\$ millions)	(\$ millions)
1969	4	\$ 37.68	\$ 55.90	\$13.98
1970	15	113.38	156.68	10.45
1971	20	259.79	345.47	17.27
1972	14	162.43	228.84	16.35
1973	20	225.97	335.06	16.75
1974	15	124.89	252.13	16.81
1975	13	82.25	147.66	11.35
1976	32	603.53	823.50	25.73
1977 (9 mos.)	6	102.27	110.03	13.37
Total	139	\$1,712.19	\$2,475.27	\$17.81

B. Tax-Exempt Financing

State and local governments have assisted nonprofit hospitals in capital financing by providing low cost funds through the issuance of tax-exempt bonds. The first tax-exempt bonds for other than a public hospital were issued by the Connecticut Health and Educational Facilities Authority in 1967.²⁸ Since that time, forty-eight states have authorized such tax-exempt financing. Some have set up statewide hospital financing programs in either discrete health financing authorities²⁹ or in authorities financing other projects such as educational facilities.³⁰

25. The FHA 242 mortgage represented, on the average, 69.2% of the value of the total project.

26. ICF, INC., *supra* note 12, at 68.

27. The source for this table is *id.* at 17.

28. Letter from Robert C. Hector, Executive Director, State of Connecticut Health and Educational Facilities Authority, to author (March 30, 1979) (copy on file in the office of the *North Carolina Law Review*). The bonds were sold competitively at a net interest cost of 5.7%. *Id.*

29. Examples include the New Jersey Health Care Facilities Financing Authority, N.J. STAT. ANN. § 26-21 (West Cum. Supp. 1978), and the North Carolina Medical Care Commission, N.C. GEN. STAT. § 131A (Supp. 1977).

30. Examples include the Connecticut Health and Educational Facilities Authority, CONN.

Others have authorized local governmental units to issue tax-exempt bonds for hospitals.³¹ Table 2 outlines the options available to hospitals in each state. The state and local governments expect two major benefits from authorizing and providing tax-exempt financing. First, hospital construction is encouraged—an important consideration where expansion or modernization and renovation is desired. Second, to the extent tax-exempt financing is substituted for financing with higher interest costs, expenditures for health care are lowered. The direct benefits to states in lower expenditures for Medicaid are somewhat offset by a loss of state (and local) income tax collections in states with such taxes, and in which the income on the bonds is exempt. Most of the tax revenue loss occurs, however, at the federal level.³²

The legal structure and program guidelines imposed on participating hospitals vary widely across states and, in some cases, across programs within states. For example, the agreement between the financing authority and the hospital can be in the form of a mortgage or a lease; the Dormitory Authority of the State of New York has issued bonds backed by both forms of agreement. The Authority may require a first mortgage lien on the entire hospital, regardless of the portion of the hospital actually involved in the construction project, or require a lien only on the specific asset financed.³³ The New York State Housing Finance Agency has taken the former position³⁴ and the Idaho Health

GEN. STAT. ANN. § 10-335 (West Cum. Supp. 1979), and the Massachusetts Health and Educational Facilities Authority, MASS. GEN. LAWS ANN. ch. 53, §§ 1-23 (Law. Co-op. 1979).

31. In Pennsylvania, for example, there are over fifty local authorities that have issued tax-exempt hospital bonds. See BUTCHER & SINGER, INC., HOSPITAL AUTHORITIES OF THE COMMONWEALTH OF PENNSYLVANIA DECEMBER 31, 1978 YEAR-END BOND VALUATIONS (1979) (copy on file in the office of the *North Carolina Law Review*). See also PA. CONS. STAT. ANN. § 2199.5 (Purdon Supp. 1979).

32. See 16 PA. CONS. STAT. ANN. § 2199.5 (Purdon Supp. 1979); J. PETERSON, CHANGING CONDITIONS IN THE MARKET FOR STATE AND LOCAL SECURITIES (1976). See generally JOINT ECONOMIC COMMITTEE, 94th CONG., 2d SESS., CHANGING CONDITIONS IN THE MARKET FOR STATE AND LOCAL GOVERNMENT DEBT (Comm. Print 1976).

33. The major advantages of a first mortgage lien on the entire hospital are that all of the revenues of the hospital are pledged and that, in case of foreclosure, the property obtained will be an operating hospital. The major advantages of obtaining a first mortgage lien on only that portion of the hospital financed are that a revenue producing entity such as a laundry can be financed without disturbing existing financing arrangements, and that new mortgages for additional construction can be obtained from alternate sources without refinancing the existing mortgage.

34. N.Y. PUB. HEALTH LAW § 2874 (McKinney 1979).

TABLE 2³⁵

HEALTH FACILITIES FINANCING AUTHORITIES

State	State Authority For Issuing Tax-Exempt Bonds	State Legislation Enabling Governmental Units to Issue Tax-Exempt Bonds
Alabama	—	X
Alaska	(1)	—
Arizona	(2)	X
Arkansas	—	X
California	—	—
Colorado	X	X
Connecticut	X	—
Delaware	X	—
District of Columbia	—	—
Florida	—	X
Georgia	—	X
Hawaii	X	—
Idaho	X	—
Illinois	X	X
Indiana	—	X
Iowa	—	X
Kansas	—	X
Kentucky	(2)	X
Louisiana	X	X
Maine	X	—
Maryland	X	—
Massachusetts	X	—
Michigan	X	X
Minnesota	—	X
Mississippi	—	X
Missouri	(3)	—
Montana	—	X
Nebraska	—	X
Nevada	—	—
New Hampshire	X	—
New Jersey	X	—
New Mexico	—	X
New York	X	(4)
North Carolina	X	X
North Dakota	—	X
Ohio	—	X
Oklahoma	—	X
Oregon	—	X
Pennsylvania	—	X
Rhode Island	X	—
South Carolina	—	X
South Dakota	X	X
Tennessee	—	X
Texas	—	X
Utah	—	X
Vermont	X	—
Virginia	—	X
Washington	(3)	—
West Virginia	—	X
Wisconsin	(3)	X
Wyoming	—	X
Total	24 (18 active)	34

(1) Statute requires amendment. (2) Established but inactive.

(3) Awaiting test case. (4) Suffolk County only.

35. This table was prepared by Mary Alice Lightle of the American Hospital Association for

Facilities Authority the latter.³⁶ Finally, the terms of the agreements vary greatly. The variables include duration of the loan, repayment schedule (level principal, level debt service or some other arrangement), maximum loan size, availability of construction financing, availability of equipment financing, amount of refinancing permitted and amount of total project cost that the hospital must raise from its own funds.

The initial security for all bonds is the capacity of the financed hospital to generate sufficient revenue to repay interest, principal, and required reserves as well as to continue meeting operating costs. The financing programs vary, however, in the additional tiers of security they provide the investors.³⁷ The first potential level of security above the revenue generating capacity of the hospital is a debt-service reserve fund sufficient to pay the hospital's debt service obligations for a certain period of time (usually less than two years) while the hospital is encountering short-term financial problems or foreclosure proceedings are underway. Bonds secured by the revenue stream of a hospital or by the revenue stream plus a debt-service reserve fund are revenue bonds. The next potential level of security is a pledge by a governmental entity to repay the bonds if the hospital cannot. Such a pledge can take two forms: a "moral obligation" under which a governmental entity is authorized but not legally required to make funds available for payments, or a "legal obligation" or "general obligation" under which a governmental entity is required to make payments and must even raise taxes if necessary to meet the debt service obligations. Examples of both types are illustrated in Diagram 2; numerous variations involving different combinations of security tiers exist.

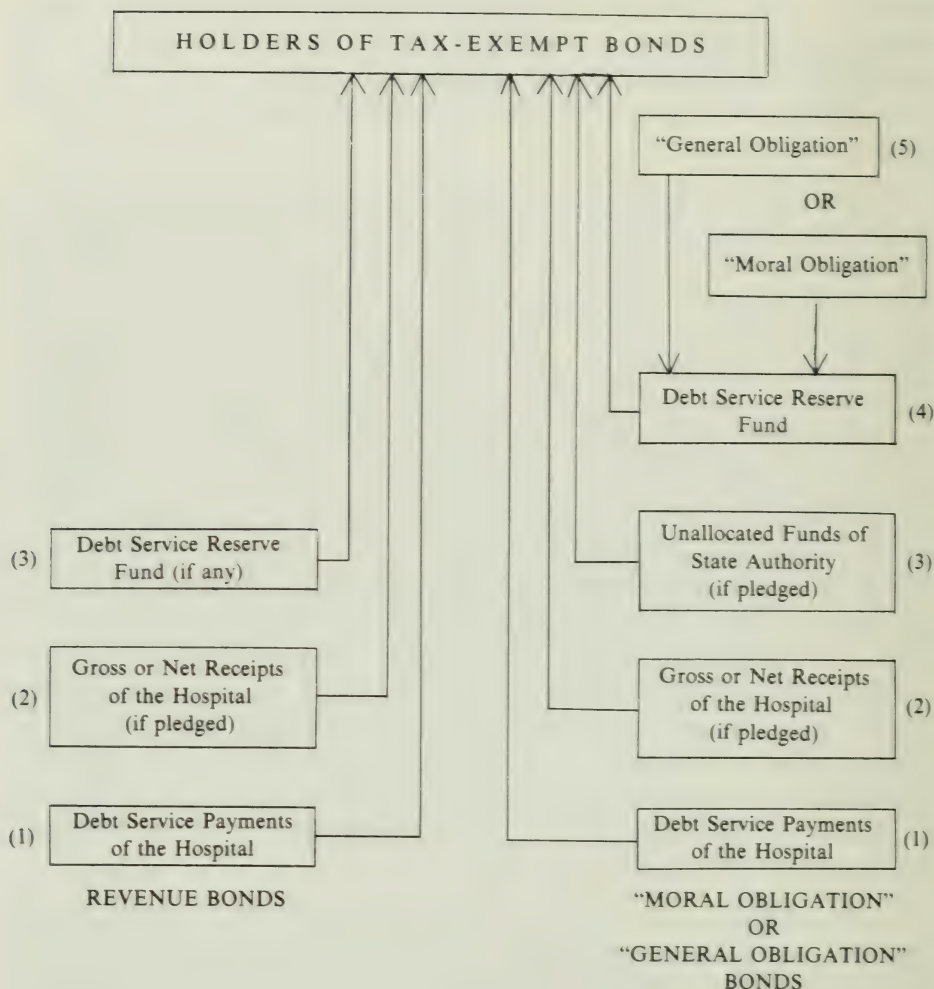
In addition to the type of security, the marketability of bonds and their interest rates depend upon the credibility and reputation of the issuing entity in the market, the creditworthiness of the particular hospital, the extent to which the bonds are collateralized, the type of hospital reimbursement in the particular state, the extent to which interest

the Council of Health Facilities Financing Authorities, Spring Meeting (Feb. 28-March 3, 1979, Denver, Colo.).

36. IDAHO CODE § 39-1450 (1978 Supp.).

37. For example, to secure the pledge of payment by the hospital, most authorities, before turning to another level of security, require a pledge of the gross or net revenues of the hospital and establishment of a mechanism to assure access to such revenues if the hospital fails to make a required payment. For a definition of gross and net revenue pledges, see note 20 *supra*. See, e.g., Regulatory Agreement Between Lutheran Medical Center and Commissioner of Health of the State of New York (Nov. 19, 1974) [hereinafter cited as Regulatory Agreement] (copy on file in the office of the *North Carolina Law Review*).

DIAGRAM 2
TAX-EXEMPT BOND FINANCING: STRUCTURE OF SECURITY



payments on the bonds are tax exempt (federal, state, and local), the term of the bonds, the size of the issue, the rating assigned by the principal rating agencies (Moody's Investors Service, Inc. and Standard and Poor's Corp.), whether the bonds are publicly sold or privately placed, and the market conditions at the time the bonds are sold.³⁸ The range of interest rates on tax-exempt hospital bonds is a substantial reflection of this array of variables. In 1978, the interest rates ranged

38. For a discussion of characteristics of bond issues that affect marketability, see NEW YORK INSTITUTE OF FINANCE, *FUNDAMENTALS OF MUNICIPAL BONDS* 27-31 (rev. ed. 1978).

from 4.2 percent on a \$345,000 general obligation issue of the Kalkaska County (Michigan) Hospital Authority, to 9.8 percent on a \$4.9 million revenue issue of the Huntsville (Alabama) Medical Clinic Board.³⁹ Wide variations occur even among the issues of a single authority. For example, in 1978, the Maryland Health and Higher Educational Facilities Authority sold one \$10 million issue at an interest rate of 6.75 percent⁴⁰ and another issue of over \$15 million at 8 percent.⁴¹

From 1972 to 1977, total tax-exempt financing for hospitals nationwide was estimated at \$12 billion, of which an estimated \$3.2 billion was for refinancing existing indebtedness, \$5.8 billion for actual construction, and \$3.0 billion for capitalized interest, debt service reserve fund deposits and other nonconstruction costs.⁴² Annual tax-exempt financing for hospitals escalated from an estimated \$.5 billion in 1972 to \$4.9 billion in 1977.⁴³ The use, however, was not evenly distributed across the country—fifteen states accounted for over 75 percent of all tax-exempt financing.⁴⁴

39. Winders, *Tax Exempt Financing for Hospitals Drops 34% in '78 to \$3,121,689,400*, THE DAILY BOND BUYER, January 19, 1979, at 1, 10-13.

40. Official Statement, \$10,030,000, Maryland Health and Higher Educational Facilities Authority, Revenue Bonds, Suburban Hospital Issue, Series A (June 28, 1978) (copy on file in the office of the *North Carolina Law Review*).

41. Official Statement, \$15,290,000 Maryland Health and Higher Educational Facilities Authority, Revenue Bonds, Howard County General Hospital Issue, Series A (November 21, 1978) (copy on file in the office of the *North Carolina Law Review*).

42. See ICF, INC., *supra* note 12, at 15 (Table 11-7). Two major sources of data on tax-exempt financing by hospitals are the American Hospital Association's *Survey of the Sources of Funding for Hospital Construction*, which appears annually in HOSPITALS, and THE DAILY BOND BUYER. The American Hospital Association *Survey* does not cover the universe of hospitals in the United States and involves only construction financing and not refinancing. THE DAILY BOND BUYER reports all public and some negotiated sales of hospital tax-exempt revenue bonds. It is not possible, however, to extrapolate the number of hospitals involved because some authorities finance multiple projects in a single bond issue, others finance a single project in more than one bond issue, and some finance and then refinance the same project. Moreover, all negotiated sales are not reflected. As a result there are no accurate estimates of the number of hospitals that have received the benefits of tax-exempt financing.

During 1977 and early 1978 when interest rates were at a low ebb relative to earlier periods, a significant number of advance refundings of hospital revenue bonds were undertaken. In an advance refunding, bonds are issued to redeem bonds that are outstanding at a higher interest rate. The primary goal of such refundings is, in most cases, to lower interest costs over the life of a bond issue. However, the Internal Revenue Service proposed restrictive regulations in September 1978, 43 Fed. Reg. 39,822 (1978), revised in October, 43 Fed. Reg. 19,675 (1978) and issued in final form in June 1979, 44 Fed. Reg. 32,657 (1979). These regulations work to limit the amount of costs of issuance that could be included within the arbitrage limitation, and therefore constrained the number of projects for which advance refunding was advantageous. Even before the regulations were adopted in final form, authorities complied with them to avoid the consequences of a potential future determination that bonds issued subsequent to the proposed regulations are arbitrage bonds and therefore not exempt from federal income taxes.

43. ICF, INC., *supra* note 12, at 15.

44. *Id.*

C. Combined Federally Insured Tax-Exempt Financing

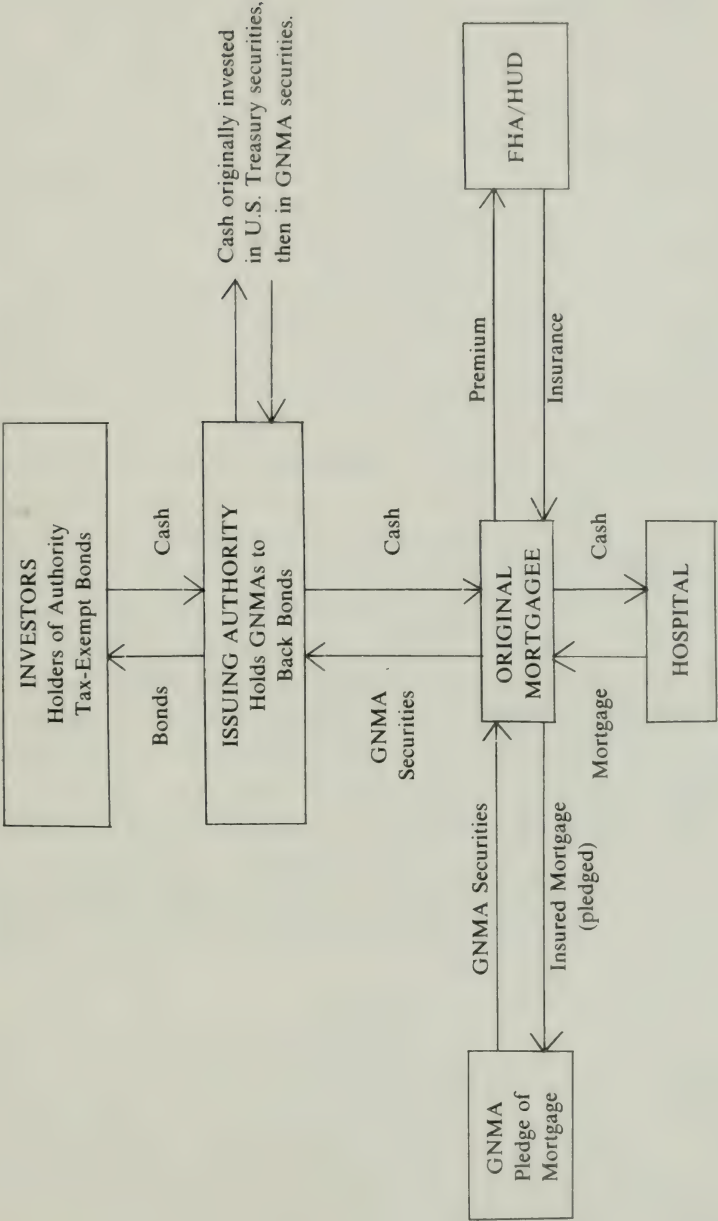
Recently, FHA 242 insurance with GNMA participation was combined with tax-exempt financing, resulting in significantly lower long-term interest rates than a hospital could have obtained from either a conventional FHA 242/GNMA combination or tax-exempt financing alone.⁴⁵ As depicted in Diagram 3, the participants included the hospital, the hospital financing authority, FHA, GNMA, and a financial organization that is both an FHA-approved mortgagee and an approved issuer of GNMA securities (the original mortgagee). The hospital arranged for FHA 242 insurance and a commitment from GNMA for issuance of GNMA mortgage-backed securities. Simultaneous with the mortgage closing, the authority issued tax-exempt bonds and agreed to use the proceeds to purchase GNMA securities as they were issued. In the meantime, the proceeds of the authority's tax-exempt bond issue were invested in United States Government obligations. When the hospital drew down the mortgage funds from the original mortgagee, GNMA issued securities in the amount of the advance. The authority liquidated its investment of the bond proceeds and purchased the GNMA securities from the original mortgagee. The original mortgagee's investment was taken out with each advance. Ultimately, the original mortgagee had no financial investment but remained the mortgagee of record. The risk of the investor in the authority bonds was de minimus throughout this process: authority bonds were backed at all times by United States Government obligations. The first financing of this type was accomplished by the Dormitory Authority of the State of New York in August 1978.⁴⁶

From the point of view of the hospitals and the states, this was the ideal financing method: the hospital paid an exceptionally low interest rate, and the state or state authority had virtually no risk. Within the federal government, however, serious questions were raised regarding the appropriateness of combining exemption from federal income tax with what is essentially a federally guaranteed security. The first concern was the amount of federal subsidy provided. Early in the discus-

45. BLYTH EASTMAN DILLON HEALTH CARE FUNDING, INC., FHA/GNMA/TAX-EXEMPT COMBINATION PROGRAM—A NEW FINANCING ALTERNATIVE FOR HOSPITALS (1978).

46. Private Placement Memorandum, Dormitory Authority of the State of New York, GNMA Collateralized Bond Issue: The Elizabeth A. Horton Memorial Hospital, Middletown, New York (July 5, 1978) (copy on file in the office of the *North Carolina Law Review*).

DIAGRAM 3
COMBINED FEDERALLY INSURED, TAX-EXEMPT FINANCING



sions of this methodology, the President of GNMA summarized the issue:

[W]e are concerned with the broad policy implications of knowingly guaranteeing securities which will in turn be used to collateralize tax exempt local debt. The use of tax exempt debt reduces Federal Government revenues and this loss of revenues represents a subsidy to the bond issuers that must be paid for by taxpayers in general.⁴⁷

The second concern was the extent of the security provided to the holders of tax-exempt bonds: "The Treasury has traditionally opposed the combination of federal guarantees and tax exemption on the grounds that it creates a security which is better than the government's own obligations."⁴⁸ The third concern was that the financial configuration entirely removed the financial feasibility of the hospital project itself from the scrutiny of the marketplace. The tax-exempt bonds were rated and purchased on the basis of the guarantee of the federal government. Finally, the methodology was being pursued (but was never applied) in the housing area, which had a much larger potential volume and, therefore, a greater potential for draining the federal coffers by reducing income tax collections.

As a result of these concerns, this method of hospital financing was discontinued by HUD in early 1979 for hospitals and proscribed for all housing except low-income, multi-family subsidized housing.⁴⁹ At the time, only four hospital financings using this method had been completed throughout the country,⁵⁰ but a significant number of applications were pending. The negative aspects of these combination financings—especially the loss of tax revenue—apparently outweighed the salutary effects of lower health care costs. Efforts to reverse this decision, including a suit by one hospital closed out of the program⁵¹

47. Letter from John Dalton, President, GNMA, to J. Christopher McCurdy, Assistant Vice President, Mercantile Mortgage Company (June 14, 1978). Dalton eventually approved a project that employed the methodology; Letter from John Dalton to Edward Shapoff, Senior Vice President, Blyth Eastman Dillon Health Care Funding, Inc. (July 21, 1978) (copies on file in the office of the *North Carolina Law Review*).

48. [1978] 6 HOUS. & DEV. REP. (BNA) 426.

49. Telegram from Lawrence Simons, Assistant Secretary, HUD, to all Regional Housing Administrators, Area Office Managers, and Insuring Office Directors (March 29, 1979) (copy on file in the office of the *North Carolina Law Review*); see Ferris, *HUD Eliminates Federal Guarantees of Housing, Hospital Bond Issues*, THE DAILY BOND BUYER, April 5, 1979, at 1, 18.

50. The four projects were: Elizabeth A. Horton Memorial Hospital, Dormitory Authority of the State of New York, \$26,078,100; United Hospital, Dormitory Authority of the State of New York, \$19,890,000; Raritan Bay Health Services Corporation, New Jersey Health Care Facilities Financing Authority, \$22,610,000; Walther Memorial Hospital, \$9,013,700, Illinois Health Facilities Authority.

51. *Beth Israel Medical Center v. Harris*, No. 79-1038 (D.D.C., filed April 11, 1979).

and a vigorous campaign by underwriting firms, have been unsuccessful to date. Unless there is a policy or statutory change,⁵² the four outstanding projects will remain anomalies.

II. GOVERNMENT FINANCING IN NEW YORK

The State of New York's entry into the arena of tax-exempt financing for hospitals was closely linked with its early efforts at health planning. In 1964, the state established a statewide health planning network—the first certificate of need program in the nation.⁵³ The original approach was modified and strengthened in 1965⁵⁴ as a result of the recommendations of a citizen's group appointed by the Governor to review hospital services.⁵⁵ The regulation of hospitals was consolidated in one agency, the Department of Health (Department). The Department was given authority not only to approve construction proposals, but also to control reimbursement and review quality of care.

The citizen's group outlined the steps they believed were required for planning a better health care system within the state.⁵⁶ An impor-

52. U.S. Representative John J. Cavanaugh has indicated that he will introduce legislation "grandfathering" hospital projects that were under consideration at the time the HUD decision was made. See Ferris, *Plan to Allow HUD Hospital Deals to Proceed is Expected Today*, THE DAILY BOND BUYER, June 6, 1979, at 1, 18; *Treasury Expresses Misgivings About HUD Hospital Bonds*, THE DAILY BOND BUYER, May 23, 1979, at 1; *Compromise Measure Eyed to "Grandfather" Hospital Deals*, THE DAILY BOND BUYER, May 21, 1979, at 15.

53. Act of April 22, 1964, ch. 730, 1964 N.Y. Laws 1883 (codified at N.Y. PUB. HEALTH LAW § 2904(a) (McKinney 1977)), created the Hospital Review and Planning Council (HRPC), comprised primarily of representatives of the health care delivery industry, and seven regional hospital planning councils. The HRPC, with the advice of the regional councils, was to consider and review all applications for the incorporation or establishment of new health institutions, and all proposals for construction or renovation. In addition, this Act established the four fundamental tests for approval of establishment or construction by the Department of Health or, at the time, the Board of Social Welfare: (i) public need, (ii) character and competence of sponsor or owner, (iii) financial resources, (iv) such other matters as it shall deem pertinent. *Id.* § 2801(a)(2).

54. Act of July 19, 1965, ch. 795, 1965 N.Y. Laws 1873 (codified at N.Y. PUB. HEALTH LAW §§ 2800-2809 (McKinney 1977)).

55. The Governor's Committee on Hospital Costs was a committee of citizens appointed on May 25, 1964, by Governor Nelson A. Rockefeller. Report of the Governor's Committee on Hospital Costs 2 (1965). The mandate to the Committee was:

(1) to study the costs of general hospital care in the State and to make recommendations as to how hospitals may best provide high quality care at the lowest possible cost and (2) to examine the present apportionment of responsibility among State agencies concerned with hospital care and to make recommendations as to how the responsibility of State government may be most effectively carried out.

Id.

56. The objectives of the planning process envisioned by the Committee were as follows:

(1) Inventory the existing health care system (During this step the interrelationships among facilities would be defined, such as the effect additional long term care beds would have on the need for acute care hospital beds within an area.), (2) Define a health

tant tool for implementing the plan was a program for financing hospital plant modernization, rehabilitation and replacement:

The Committee stresses the community nature of the responsibility for making up the backlog of plant needs, both those of obsolescence and those of currently needed but unbuilt structures. It also calls attention to the opportunity implicit in broad-based community financing for replenishment and expansion of plant to impart systematic community-wide pattern to the configuration of facilities. This can be done by making public financing contingent upon the compliance of sponsors with the specifications and ideals of well-conceived community plans.⁵⁷

The Committee called for a major program of state funding for these projects, preferably through low-interest, long-term loans. This recommendation was implemented for nursing homes in 1966⁵⁸ and for hospitals in 1970.⁵⁹

The hospital financing program that was created reflected the legislative intent of the statute:

Many hospitals and other health facilities throughout the state are becoming obsolete and are no longer adequate to meet the needs of modern medicine. As a result of rapid technological changes, such facilities require substantial structural or functional changes. Others are unsuited for continued use by virtue of their existing plants and

care system which matches appropriate resources to people's health needs (This kind of system could remove duplicative services, assure accessibility to health care, and minimize the number of people receiving care in excess of their needs.), and (3) Design a "plan of action" which would be a goal oriented planning process showing how to move from the existing to the desired health care system.

LEGISLATIVE COMMISSION ON EXPENDITURE REVIEW, HEALTH PLANNING IN NEW YORK STATE S-1 to S-2 (Program Audit, January 3, 1977).

57. Report of the Governor's Committee on Hospital Costs, *supra* note 55, at 77. The Committee also recommended a similar program for nursing homes. *Id.* at 77-78.

58. In 1965 the New York Legislature gave final approval to an amendment of the New York Constitution which recognized the public purpose of providing nursing home accommodations to individuals with low income. The amendment, which modified art. 4, §§ 1, 2, was approved at the 1965 general election and became effective on January 1, 1966. See 1966 N.Y. Laws 3552-53 (appendix). The legislature implemented the constitutional authorization in 1966 by enacting the Nursing Home Companies Law, 1966 N.Y. Laws 2425 (codified at N.Y. PUB. HEALTH LAW §§ 2850-2866 (McKinney 1977)), and amending the Private Housing Finance Law to authorize the New York State Housing Finance Agency (HFA) to issue bonds for nursing homes, Act of July 28, 1966, ch. 813, 1966 N.Y. Laws 2435 (codified at N.Y. PUB. HEALTH LAW §§ 2850-2866 (McKinney 1977)).

59. In 1969, the Legislature gave final approval to an amendment of the New York Constitution which established a new § 7 of art. XVII authorizing loans to hospitals. The amendment was approved at the 1969 general election and became effective on January 1, 1970. See 1970 N.Y. Laws 3530 (appendix). During 1969, the legislature enacted the Hospital Mortgage Loan Construction Law, 1969 N.Y. Laws 2602 (codified at N.Y. PUB. HEALTH LAW §§ 2870-2882 (McKinney 1977)) and amended the Private Housing Finance Law to authorize HFA to issue bonds for hospitals. The law was to become effective only in the event that the constitutional amendment was approved by the electorate. *Id.*

should be replaced. Such inadequate and outmoded facilities deny to the people of the state the benefits of health care of the highest quality, efficiency, and promptly provided at a reasonable cost
⁶⁰

A. *Housing Finance Agency*

The New York State Housing Finance Agency (HFA) was the agency designated to implement this program. A brief review of the history of HFA explains this designation as well as the financial and programmatic structure of the hospital program. When created in 1960, HFA's mandate was to finance the construction of low and middle-income, multi-family housing throughout the state by selling bonds to the private sector to obtain funds to make mortgage loans.⁶¹ It was an independent public benefit corporation chartered by a special act of the legislature in response to growing voter reluctance to approve referenda authorizing state financing of housing by the issuance of state debt.⁶²

New York and other states had frequently by-passed voter referenda and other constitutional limitations on debt issuance by creating independent authorities to issue revenue bonds, but HFA was the first such authority created to finance privately owned housing.⁶³ The security for HFA bonds was different from that of earlier bonds. The "moral obligation" of the state was explicitly stated as additional security for the bonds.⁶⁴ This tier of security was necessary to improve the

60. Act of May 26, 1969, ch. 1035, 1969 N.Y. Laws 2602 (codified at N.Y. PUB. HEALTH LAW § 2871 (McKinney 1977)).

61. See New York State Housing Agency Act, N.Y. PRIV. HOUS. FIN. LAW § 41(2) (McKinney 1976).

62. MORELAND ACT COMMISSION ON THE URBAN DEVELOPMENT CORP. AND OTHER STATE FINANCING AGENCIES, RESTORING CREDIT AND CONFIDENCE: A REFORM PROGRAM FOR NEW YORK STATE AND ITS PUBLIC AUTHORITIES 88 (1976) [hereinafter cited as MORELAND ACT COMMISSION]. For a brief summary of the origin and history of HFA see A. WALSH, THE PUBLIC'S BUSINESS 129-40 (1978).

63. For a discussion of the manner in which New York and other states have circumvented debt limitations and referenda requirements, see Utevsky, *The Future of Nonguaranteed Bond Financing in New York*, 45 FORDHAM L. REV. 863 (1977).

64. The actual wording of the so called "moral obligation" provision is as follows:

In order further to assure the maintenance of such debt service reserve funds, there shall be annually apportioned and paid to the agency for deposit in each debt service reserve fund such sum, if any, as shall be certified by the chairman . . . to the governor and director of the budget as necessary to restore such reserve fund to an amount equal to the maximum amount of principal and interest maturing and becoming due and sinking fund payments required to be made in any succeeding calendar year on the . . . bonds of the agency then outstanding and secured by such reserve fund. The chairman . . . shall annually, on or before December first, make and deliver to the governor and director of the budget his certificate stating the sum, if any, required to restore each such reserve

marketability of the bonds.⁶⁵ Also, HFA bonds were backed by the revenues of a number of projects—a “pool”—rather than the revenues of an individual project.⁶⁶ This avoided the more expensive and time consuming process of selling a myriad of small bond issues, and provided additional security for investors.⁶⁷

The HFA, unlike the Port of New York Authority,⁶⁸ the New York Power Authority, and other authorities in existence at the time, was primarily a financing, and not a development authority.⁶⁹ As a consequence, in the housing program the private sponsor of the housing project was responsible for project plan, design and construction, and a separate state regulatory agency supervised all aspects of the project from construction to operation.⁷⁰

Almost as soon as it began, HFA's role was expanded. It was authorized to finance construction of the State University system in 1962,⁷¹ mental hygiene facilities in 1963⁷² and municipal health facilities in 1968.⁷³ The bonds for each program were independently secured, one from the other, by a separate one-year debt service reserve fund and the assets and revenues were segregated and separately pledged.⁷⁴

The hospital and nursing home programs were logical additions to

fund to the amount aforesaid, and the sum or sums so certified, if any, shall be apportioned and paid to the agency during the then current state fiscal year.

N.Y. PRIV. HOUS. FIN. LAW § 47(5)(c) (McKinney 1976).

65. For a discussion of the origin of the “moral obligation” concept, and the perceptions of the individuals involved in establishing the first “moral obligation” bonds for HFA, see MORELAND ACT COMMISSION, *supra* note 62, at 108-15, and A. WALSH, *supra* note 62, at 129-33.

66. While the individual bonds cannot be identified with a particular project, the proceeds of the bond and note issues are strictly segregated on a project by project basis. Therefore, the projects for which the proceeds are to be used and the amounts for each project are specifically identified at the time of the bond or note sale. MORELAND ACT COMMISSION, *supra* note 62, at 96-97.

67. Many of HFA's mortgages, especially housing and nursing home mortgages, are for relatively small amounts (less than \$10 million). Some of the costs of a bond issue do not vary significantly with the size of the issue so there are economies of scale (both for expenses and for record-keeping) in undertaking pooled issues. *Id.*

68. The “Port of New York Authority” is now known as the “Port Authority of New York and New Jersey.” See N.Y. UNCONSOL. LAWS § 6404 (McKinney 1979).

69. MORELAND ACT COMMISSION, *supra* note 62, at 86-97.

70. The Commissioner of Housing and Community Renewal was responsible for such supervision. See N.Y. PRIV. HOUS. LAW §§ 43, 44, 44-a, 44-b, 50, 55 (McKinney 1976).

71. Act of March 30, 1962, ch. 251, § 381, 1962 N.Y. Laws 1073 (codified at N.Y. PRIV. HOUS. FIN. LAW § 47-a (McKinney 1976)).

72. Act of April 30, 1963, ch. 932, § 29-1, 1963 N.Y. Laws 2867 (codified at N.Y. UNCONSOL. LAWS § 4414 (McKinney 1979)).

73. Health and Mental Hygiene Facilities Improvement Act, ch. 359, § 14, 1968 N.Y. Laws 1348 (codified at N.Y. UNCONSOL. LAWS § 4414 (McKinney 1979)).

74. See Official Statement of New York State Housing Finance Agency, Health Facilities

HFA's repertoire and were modeled after the existing mortgage programs.⁷⁵ The financial structure closely followed that of all of HFA's programs: the bonds were backed by a one year's debt service reserve fund and the state's "moral obligation," and were sold for a pool comprised of a number of projects. The program structure closely followed that of HFA's housing mortgage programs and HFA's role was primarily financing, not project development. Private nonprofit hospitals and nursing homes were responsible for initiating projects, obtaining necessary approvals, and contracting with private firms to construct the projects. They were, however, subject to the statutorily mandated supervision of the State Commissioner of Health (Commissioner). The structure of the HFA hospital and nursing home program is quite different from that of most other state tax-exempt hospital programs, which employ individual revenue bonds and are not directly linked with the state health regulatory agency.

The HFA hospital financing program was designed to provide construction and start-up funds for new hospitals and for extensive modernizations and renovations of existing hospitals. This had important ramifications for the structure of the program. HFA required a first mortgage lien on the entire operating hospital regardless of the actual construction financed,⁷⁶ a pledge of all the revenues of the hospital⁷⁷ and an entirely code-conforming hospital at the completion of the construction program. (A code-conforming hospital does not run the risk of significant revenue losses from the decertification of non-code-conforming portions of the existing hospital.) This approach provided the most extensive security for the bondholders. In the event a hospital defaults on payments, HFA can intercept revenues to meet its mortgage obligations through the pledge of the hospital's gross receipts. If foreclosure becomes necessary, HFA's first mortgage lien on the entire hospital assures that the property taken is an operating hospital that can continue to provide services and generate revenue. As a corollary, however, the first mortgage lien on the entire hospital and the pledge of

Bond Anticipation Notes 2 (April 10, 1979) (copy on file in the office of the *North Carolina Law Review*).

75. The hospital program is authorized by N.Y. PUB. HEALTH LAW §§ 2870-2882 (McKinney 1977). The nursing home program was authorized by *id.* §§ 2850-2869.

76. *Id.*; see note 34 *supra*.

77. The hospitals are required to pledge their gross revenues, including income, earnings and receipts regardless of their source (excluding, however, any revenues, income, receipts and earnings which are expressly restricted by law or any instrument of deed, trust or will as to their use or application). A specific mechanism was put in place to capture these revenues should payments not be made. See, e.g., Regulatory Agreement, *supra* note 37.

all hospital revenues mean that for any additional capital borrowing for renovation or expansion, the hospital must either increase its HFA mortgage or refinance it. Thus, HFA must be prepared to consider mortgage increases when additional construction is necessary.

There are additional ramifications of directing the program toward new projects or major reconstructions. Many hospital projects that would be eligible for financing by authorities in some other states were automatically excluded from consideration by HFA. For example, HFA did not finance small projects that were self-supporting in relation to the overall hospital complex, such as laundries and parking garages, but for which the hospital was unwilling to pledge its entire facility and gross revenues. Hospitals with substantial outstanding indebtedness also were ineligible. Initially, the statute did not even provide for refinancing of existing indebtedness; it was later amended to permit refinancing of mortgages held by institutional lenders in amounts reasonably related to the construction program.⁷⁸

In implementing the program, HFA and the Commissioner had different orientations and, in some cases, different concerns. HFA's responsibilities under the statute,⁷⁹ bond resolution,⁸⁰ and mortgage⁸¹ centered implicitly on protecting the interests of its bondholders. This involved, among other activities, reviewing the financial viability of the project and assuring that the property was unencumbered.⁸²

The Commissioner, on the other hand, had two levels of responsibility. His primary responsibilities under the general provisions of the Public Health Law were to assure that health care was readily available to the citizens of the state, was of high quality and was reasonably priced.⁸³ At the same time, under the provisions specifically relating to the HFA program, he had special responsibilities for hospitals financed by HFA. These responsibilities were directed primarily toward maintaining the revenue generating capacity of the hospital and thereby protecting the investor. They included identifying projects for HFA

78. Act of June 17, 1971, ch. 583, § 1, 1971 N.Y. Laws 878 (codified at N.Y. PUB. HEALTH LAW § 2872(5) (McKinney 1977)).

79. N.Y. PRIV. HOUS. FIN. LAW § 41(2) (McKinney 1976).

80. New York State Housing Finance Agency, Resolution Adopted Jan. 8, 1970, Authorizing Issuance of New York State Housing Finance Agency Hospital and Nursing Home Project Bonds, and Supplemental Resolution adopted Oct. 3, 1977 (copies on file in the office of the *North Carolina Law Review*).

81. See Standardized Form Mortgage of the New York State Housing Finance Agency (1970) (copy on file in the office of the *North Carolina Law Review*).

82. *Id.*

83. N.Y. PUB. HEALTH LAW § 2800 (McKinney 1977).

financing that were needed on a planning basis and were financially viable, supervising ongoing operations, and actually intervening and operating the hospital should it encounter serious difficulties or be improperly managed.⁸⁴

Ideally, the Commissioner's responsibilities were to be mutually supporting: projects were only to be undertaken in the context of a comprehensive plan for hospital care that took into consideration the long-range needs of the communities and then only after a review of their cost effectiveness. In actual practice, however, once the projects were operational, there was a potential for conflict. Projects that had met existing community needs when they were planned, could be made superfluous by factors such as changes in medical practice patterns, demographics, or the standards of need and occupancy set by the Commissioner. Yet, the consideration the Commissioner could give to reducing the services provided or imposing financial restrictions had, necessarily, to be weighed against his responsibilities for assuring the continued operation of the project.

In implementing the program, HFA and the Commissioner worked cooperatively, but pursued their own responsibilities. This overlap in responsibilities acted as a check and balance. The Commissioner identified projects for HFA consideration from those hospitals that had successfully hurdled the certificate of need and other review procedures required for all hospital construction regardless of source of financing. There were no specifically articulated criteria for selecting among approved projects, and the Commissioner thus had full discretion in making his selections. As a result, the Commissioner was often subject to intense pressure from hospitals interested in obtaining financing and from local representatives concerned with improving the health care services in their areas.

Once a project was designated for consideration by HFA, specific reviews and certifications were required from the Department before HFA would provide financing for the project. The statute addresses five major areas: compliance with all relevant provisions of the public health law, conformity of the plans and specifications with code requirements, sufficiency of revenues to meet expenses, availability of funds to make the equity contribution, and the existence of a "regula-

84. *Id.* § 2878 provides not only that the Commissioner of Health may operate a hospital when HFA has acquired the fee title, through foreclosure or otherwise, but also that the Commissioner may, whenever there is any violation or anticipated violation of any requirement, proceed against the hospital in the New York Supreme Court. In such an action, the court may appoint a temporary or permanent receiver.

tory agreement" between the hospital and the Commissioner⁸⁵ designed to provide the Commissioner with special controls over the project during the operational period.⁸⁶ This statutory mandate was the basis for detailed reviews by the Department of proposed HFA projects, including evaluation of the code conformance of the entire project, determination of all forms of insurance coverage during and after construction and analysis of funds required for the start-up period.⁸⁷

In practice, the review process was quite fluid. Once the Commissioner designated a project, HFA undertook its own independent review of the two areas that concerned it most—financial feasibility and the mortgagability of the property. Although the Commissioner had completed a preliminary financial review, HFA required an additional, detailed independent assessment by an outside consultant.⁸⁸ In addition, HFA evaluated the title, title policy and easements to assure that in the event of foreclosure there would be no controversy regarding the priority of its lien and, therefore, that the facility would be able to provide services without disruption. When the mortgage was closed and construction initiated, HFA and the Commissioner worked with the hospital to complete the project on time and within the original cost projection. These activities included monthly approvals of mortgage drawdowns by both the Commissioner and HFA and approval of all changes in plans and specifications by the Commissioner.⁸⁹

The Commissioner's dual levels of responsibility continued once the project was operational. All HFA financed hospitals are subject to the supervision the Commissioner exerts over every hospital in the state. This includes rate control, surveys of compliance with physical standards, inspections of the quality of care and certificate of need approval for construction or changes in services. The additional supervi-

85. *Id.* § 2875.

86. *Id.* § 2873, outlines the minimum provisions of the required "regulatory agreement"; specifically, the hospital must agree to refrain from sale, assignment or transfer of the property during the term of the mortgage; to obtain the consent of the Commissioner for modifications of the physical plant, borrowing of any sort and management contracts; to maintain records in a specified manner; and to provide certain financial reports.

87. See Official Statement of New York State Housing Finance Agency, Hospital and Nursing Home Project Bonds, 1977 series A, at 27 (1977) [hereinafter cited as Official Statement].

88. In all cases, the financial feasibility of the project was reviewed by an independent financial consultant. In some cases, the demand for the services to be provided by the project was assessed by the consultant, in others by the Commissioner. *Id.* at 28.

89. Once construction was completed, the Department conducted an audit to set the final mortgage amount and the allowable amount of capital reimbursement under Medicaid and Blue Cross. See 10 N.Y. ADMIN. RULES & REGULATIONS § 87.32(a), (e) (1975).

sion provided to HFA hospitals focuses on the financial soundness of the operation and includes reviews of budgets and financial reports, approval of all equipment leases, review and approval of all property transactions such as the granting of easements, leases, and sales or transfer of land, and approval of all withdrawals from the reserve for replacement.⁹⁰ HFA also reviews many of these items and monitors payment performance and financial reports to assure that the hospitals can continue to meet their mortgage obligations.⁹¹

The combination of these additional regulatory powers, the pooling of a number of projects into one bond issue and the state's "moral obligation" backing the bonds enabled HFA to finance a number of projects that would, standing on their own, have had difficulty raising capital or raising it at reasonable interest rates. These included start-up hospitals with no established financial track record, hospitals located in underserved, low-income areas, certain small rural hospitals and hospitals with limited ability to generate substantial amounts of cash for equity. They would have encountered difficulties standing alone because, as new hospitals, the rating agencies would not have been willing to rate them⁹² or because the market would have perceived risks associated with the geographic location or financial situation of the projects. Yet these projects were considered necessary, on a programmatic and planning basis, by the Commissioner and financially feasible, with the lower interest rates available through tax-exempt financing and low equity requirements, by an independent financial consultant.

From the inception of the hospital program in 1970 to 1974, HFA entered into mortgage commitments of approximately \$325 million for the construction or renovation of twenty hospitals with approximately seven thousand beds.⁹³ The projects ranged from a small upstate community hospital, which had 40 hospital and 39 nursing home beds and

90. The controlling documents are N.Y. PUB. HEALTH LAW §§ 2873, 2878(1.) (McKinney 1977); 10 N.Y. ADMIN. RULES & REGULATIONS § 87.36-.38 (1975); Standardized Form Mortgage of the New York State Housing Finance Agency, *supra* note 81. See also N.Y. PRIV. HOUS. FIN. LAW § 55.3 (McKinney 1976).

91. N.Y. PUB. HEALTH LAW § 2873(b), (c) (McKinney 1977).

92. For example, Standard & Poor's Corporation explicitly states:

We do not currently rate bond issues for nursing homes or life care centers although these areas are being researched It is our policy not to rate start-up facilities, and, similarly, we do not rate issues involving the relocation of a hospital unless a substantial portion of its patients are derived from the area to which the hospital is moving.

STANDARD AND POOR'S CORP., MUNICIPAL AND INTERNATIONAL BOND RATINGS: AN OVERVIEW 38 (1977).

93. In addition, HFA provided mortgage commitments of almost \$500 million to seventy-six nursing homes. NEW YORK STATE HOUSING FINANCE AGENCY, ANNUAL REPORT 26 (1978).

required a mortgage of less than \$1 million,⁹⁴ to a master plan for a Buffalo hospital. The latter called for an eight-year program of upgrading and expanding the existing complex to 560 beds and constructing a suburban inpatient satellite⁹⁵ and involved a mortgage commitment of \$53 million.⁹⁶

In 1973, there was concern within and outside the state government that HFA would be unable to market the volume of hospital and nursing home bonds needed to meet the state's health planning objectives while continuing to market bonds for its other programs in an orderly fashion. As a result, the Medical Care Facilities Finance Agency (MCFFA) was created.⁹⁷ It is a sister agency to HFA in that its programmatic and financial structure are identical and in that it shares HFA's Chairman, Executive Director and staff. In 1973 and 1974, MCFFA entered into mortgage commitments of over \$150 million for five hospitals involving a total capacity of over 1700 beds.⁹⁸ Its projects included the \$23 million renovation of a large upstate hospital⁹⁹ and a new 530 bed replacement hospital for a 200 bed community hospital in Brooklyn. The latter involved the renovation of an abandoned factory in a location separate from the original hospital and a mortgage of over \$60 million.¹⁰⁰

94. See Official Statement, *supra* note 87, at 56-62.

95. See *id.*

96. See NEW YORK STATE HOUSING FINANCE AGENCY, *supra* note 90, at 26.

97. MCFFA was created by the New York State Medical Care Facilities Finance Agency Act of 1973, ch. 392, § 37, 1973 N.Y. Laws 1417 (codified at N.Y. UNCONSOL. LAWS § 7411 (McKinney 1979)). The legislative intent section clearly indicated that it was designed to increase marketing capacity:

In order to permit an acceleration in the implementation of these [hospital and nursing home financing] programs in areas where the public need remains urgent, without jeopardizing the orderly marketing by the New York State Housing Finance Agency of its notes and bonds for other program purposes, it is hereby found and declared that a separate corporate governmental agency . . . be created as a single purpose agency to act in concert with [HFA] and to devote its entire energy and resources to the provision of additional funds for the construction of health and health related facilities In this manner, the broadest possible base of investment by the greatest number of the general public may be had and the initiative and strength of our private enterprise economy may most readily be harnessed for the benefit of the people of the state.

Id.

98. *Id.* In addition, MCFFA provided mortgage commitments of approximately \$50 million to eight nursing homes. NEW YORK STATE MEDICAL CARE FACILITIES FINANCE AGENCY, ANNUAL REPORT 6 (1979).

99. *Id.*

100. PEAT, MARWICK, MITCHELL & CO., SUMMARY OF CONCLUSIONS AND FINDINGS FROM COMMUNITY NEEDS STUDY I-1 (1974) (copy on file in the office of the *North Carolina Law Review*).

B. Dormitory Authority

The Dormitory Authority first entered the arena of tax-exempt hospital financing in the early 1970s.¹⁰¹ The structure of its hospital financing program was not statutorily established. Therefore, the Dormitory Authority used the financing framework of its other programs. Because its enabling statute did not contain a general authorization to finance hospitals, however, an express amendment was required for each individual hospital it intended to finance. The Dormitory Authority was empowered to finance its first hospital in the 1968 legislative session¹⁰² and made a commitment to finance the project in 1970.¹⁰³

The Dormitory Authority's approach to tax-exempt hospital financing was significantly different from that of HFA and MCFFA. The bonds were backed only by the revenue of the individual project and not by the "moral obligation" of the state, nor by a pool of projects.¹⁰⁴ Moreover, the Dormitory Authority was able to finance discrete freestanding operations,¹⁰⁵ such as parking garages and laundries, and had no restriction on the amount of refinancing it could undertake.¹⁰⁶

The Department's role in Dormitory Authority financing was quite different as well. Indeed, the scope of the Department's reviews did not extend beyond that for projects financed by private sources and was based on its overall supervisory responsibilities for hospitals. The Department did not specifically identify projects for the Dormitory Authority to consider financing as it did for HFA and MCFFA, nor did it continue to monitor projects during construction and operation. More-

101. Albany Medical Center Revenue Bonds, Series A (\$22.560 million), discussed in DORMITORY AUTHORITY OF THE STATE OF NEW YORK, ANNUAL REPORT: 1976-1977, at 28-29 (1977). In the mid-1960s, the Dormitory Authority financed two nurses residences at hospitals totaling under \$2 million: Buffalo General Hospital Revenue Bonds (\$1.175 million) and Geneva General Hospital Revenue Bonds (\$.465 million), described in *id.*

102. Act of June 22, 1968, ch. 1046, § 1, 1968 N.Y. Laws 2965 (codified at N.Y. PUB. AUTH. LAW § 1676 (McKinney Supp. 1978)).

103. DORMITORY AUTHORITY OF THE STATE OF NEW YORK, *supra* note 101, at 28-29. Duplication of functions among New York state authorities was not uncommon during this period. Both HFA and the Dormitory Authority financed construction for the State University, and even within HFA three separate programs provided hospital financing (Health Facilities, Hospitals and Nursing Homes, and State University). MORELAND ACT COMMISSION, *supra* note 62, at 100.

104. See N.Y. PUB. AUTH. LAW § 1683 (McKinney Supp. 1978).

105. *Id.* § 1678.

106. *Id.* § 1682. Certain of the other characteristics of the Dormitory Authority (DA) hospital financing program included: "The DA did not issue notes for hospital construction financing; and in the early years of the program, the DA held fee title to the property and leased it to the hospital. In the later years, it entered into a mortgage." DORMITORY AUTHORITY OF THE STATE OF NEW YORK, *supra* note 101, at 28-30.

over, the Dormitory Authority, unlike HFA and MCFFA, was both a development and a financing authority. Thus, planning, design and construction of the projects were directly supervised by the Dormitory Authority staff. From 1970 to 1975, the Dormitory Authority financed nine hospital projects in the state involving a total commitment of over \$115 million.¹⁰⁷

C. FHA 242 Insurance

During the time period in which HFA and MCFFA had made commitments of almost \$500 million to twenty-five hospitals, and the Dormitory Authority over \$100 million to nine hospitals, FHA 242 insurance had been issued for only two projects in New York—one in 1969 and one in 1975—with a total insured value of \$12.2 million.¹⁰⁸ This compared with a nationwide total of over 100 projects with an insured value of over \$1 billion.¹⁰⁹ New York hospitals had state authority financing readily available at much lower interest rates and longer terms than FHA 242 offered. As a result, they did not aggressively pursue the federal insurance program.¹¹⁰

III. THE FISCAL CRISIS AND THE STATE'S RESPONSE

In 1975, the market for New York state and state-related securities began to disintegrate in response to a number of factors, including the temporary default of the New York State Urban Development Corporation (UDC) on short-term notes,¹¹¹ the financial problems of New York City and general market concern with the rapid escalation of financing by the state and its authorities and municipalities. As one member of the underwriting community later commented, "by late 1975, the market for State and Agency paper 'closed down' as we euphemistically put it. Collapsed better describes the event."¹¹² The en-

107. See DORMITORY AUTHORITY OF THE STATE OF NEW YORK, *supra* note 101, at 28-31.

108. See ICF INC., *supra* note 12, at 68 (Table B-3).

109. *Id.*

110. *Id.* The consideration given to FHA 242 insurance in New York was aptly stated in a 1973 publication of the New York Hospital Association in which a comment on the increasing attention focused on the FHA 242 program by hospital administrators was footnoted to make it clear that this was only in states other than New York. A. GLAUDE, AN ANALYSIS OF ARTICLE 28-B, DORMITORY AUTHORITY AND HILL BURTON GUARANTEED LOAN INTEREST SUBSIDY CAPITAL FINANCING PROGRAMS FOR HOSPITALS IN NEW YORK STATE 54 (1973).

111. UDC defaulted on \$104.5 million in notes on February 25, 1975; this default was subsequently cured. MORELAND ACT COMMISSION, *supra* note 62, at 201-03.

112. Rousseau, *Project Financing Suggested as Vehicle for Hospital Bonds*, THE DAILY BOND BUYER, January 31, 1978, at 3, 18.

suing fiscal crisis and the response to it significantly affected the existing hospital financing programs and provide the context for decisions about future hospital financings in New York.

At the time the market closed, HFA and MCFFA had unbonded outstanding commitments of approximately \$2.0 billion of which approximately \$400 million were for hospital and nursing home projects.¹¹³ The implications of these figures must be viewed in the context of HFA's and MCFFA's procedures for obtaining construction and development funds for projects. During the initial stages of a project, HFA and MCFFA sold short-term obligations—one year or less bond anticipation notes. Initially, the funds were invested and, as the project progressed, advanced to pay construction and other costs. As the notes matured, HFA and MCFFA issued new short-term notes to repay the outstanding ones. When a number of projects reached a reasonable degree of completion, long-term bonds were issued to repay the notes, thus replacing a short-term security with a long-term security.¹¹⁴ An important distinction between these bonds and notes is that while the bonds are explicitly backed by the "moral obligation" of the state, the notes are not.

Notes rather than bonds were used to provide funds during the development period for a number of reasons. Under normal market conditions, the interest rates on notes are lower than those on bonds because there is less risk associated with a shorter term.¹¹⁵ Therefore, using notes resulted in lower overall project costs because it resulted in lower capitalized interest costs during the development period. Although bonds for a project might be sold one or more times during the development period, the final bond sale did not occur until construction was completed, the project was operational, and a reasonably accurate estimate of total project cost and, therefore, of total bonds required could be obtained.

This approach to construction financing required ready access to the financial market to sell notes or bonds at least annually to repay outstanding notes and to provide additional financing for outstanding or new commitments. Unfortunately, when UDC defaulted on its out-

113. HFA had approximately \$235 million and MCFFA had approximately \$145 million. Preliminary Official Statement, State of New York 1979 Tax and Revenue Anticipation Notes 36 (1979) [hereinafter cited as Preliminary Official Statement].

114. Bonds are limited by statute to a maximum term of 50 years. N.Y. PRIV. HOUS. FIN. LAW § 46(2)(a) (McKinney 1976). In practice, however, they are generally limited to 40 years.

115. HARRIS TRUST & SAVINGS BANK, PRIMER ON RELATIVE YIELD CURVE VALUES 15-19 (1977).

standing notes in February 1975, this ready access disappeared. The immediate financial impact of the UDC default on HFA was summarized by one commentator in May 1975:

It is beyond question that the corporation's default on its notes has meant that other agencies have had to pay substantially higher interest rates than otherwise would be required. And if this turns out to be more than a passing phenomenon, the costs could be enormous.

The New York State Housing Finance Agency's cost of borrowing has showed a marked increase since the UDC default. In February, before the default, HFA issued short-term bond anticipation notes for an average interest rate of 4.3 per cent. In March, the agency was able to sell only \$53 million of \$95 million in notes offered, and at an average interest rate of 7.4 per cent, more than 3 points above the February rate. In April, with the UDC notes still in default, the agency's notes were sold at about 8.3 per cent. The rate dropped slightly in May, . . . to about 7.6 per cent. During the same period, short-term notes carrying the full faith and credit of the state sold for rates more than two points lower. In recent times, the spread between the state's notes and HFA's notes has fluctuated between one point and one half a point, and HFA attributes the growth of the spread directly to the UDC debacle.

Long-term bonds issued also have been adversely affected. On April 23, the New York State Medical Care Facilities Finance Agency, which is operated by HFA, was able to sell only \$62 million of \$82 million offered in long-term bonds and at an interest rate of 9.6 per cent, the highest yet paid by a state agency.¹¹⁶

The situation deteriorated from May to October when HFA and MCFFA were entirely barred from borrowing in the public capital marketplace. At the beginning of 1975 HFA and MCFFA had already placed a voluntary moratorium on entering into any new commitments;¹¹⁷ by the end of the year they were scrambling to meet existing commitments.

In December 1975, HFA, MCFFA and two other independent authorities that had encountered similar marketing difficulties¹¹⁸—difficulties that were precipitated by events external to these authorities—joined with state officials to develop a plan for meeting temporary

116. Clark, *UDC Crisis: Future Fallout on N.Y. Bonds?*, 1 EMPIRE STATE REP. 193 (1975).

117. New York State Housing Finance Agency Memorandum from P. Belica, Executive Director, to the Agency members (March 13, 1975) (copy on file in the office of the *North Carolina Law Review*).

118. The other two authorities with outstanding indebtedness were the Dormitory Authority and the Environmental Facilities Corporation (EFC); they had respective outstanding commitments of \$300 million and \$30 million (none of it attributable to hospital projects). Preliminary Official Statement, *supra* note 113, at 36.

financing requirements.¹¹⁹ The purpose of this plan, which was put in place in March 1976, was to enable the four authorities to complete all significant projects in progress without defaulting on notes while gradually reentering the market and selling bonds in an orderly fashion. In setting the stage for such a plan, the state took a number of unprecedented steps designed to allay investor concerns and to signal the state's commitment to sound fiscal policies and financial management.

First, the state put its own financial resources on the line for the first time: it directly appropriated funds to pay certain obligations and set up a special contingency fund.¹²⁰ Second, the state placed a statutory limit on all "moral obligation" financing by all state authorities.¹²¹ As a result, all future commitments for new projects had to be financed on a revenue bond basis without extending the "moral obligation" of the state. Finally, the Public Authorities Control Board was statutorily established as an oversight mechanism to supervise borrowing activities. Its mandate was to review and approve proposals by the four authorities to incur new debt or acquire/construct new projects whether or not the projects involved the "moral obligation" of the state.¹²²

Once the plan for temporary financing was in place, the first priority of the four authorities was to find permanent sources of financing

119. The plan to provide interim financing, which became known as the "Build Out Plan," originally extended through September 30, 1978 and was subsequently extended to September 30, 1980. The "Build Out Plan" was a complex and sometimes convoluted plan to provide temporary financing for projects that had commitments from the four authorities. This plan enlisted numerous sources of financing, some of which had not previously invested in tax-exempt obligations, including but not limited to, state or state-related entities such as the Teacher's Retirement System, banks and insurance companies. The debt was placed in accordance with a carefully orchestrated plan, and the commitment of funds by one source was often contingent on participation by another source. Certain projects were suspended as part of the "Build Out Plan." *Id.* at 34-37. The complexity of the financial transactions in the period prior to the "Build Out Plan" is illustrated in Greenhouse, *A Complex Shift of Funds Saves State Finance Unit*, THE NEW YORK TIMES, October 10, 1975, at 1, col. 6. An elaborate plan had already been developed to rescue the New York State Urban Development Corporation.

120. The commitment of state funds included, but was not limited to, an appropriation of \$36 million to HFA and EFC to enable them to pay certain of their notes, a direct appropriation of \$10.1 million, pursuant to the "moral obligation" provision, to replenish the HFA Non-Profit Housing Debt Service Reserve Fund, and a stand-by appropriation of \$80 million in the event that an alternate source of repayment of maturing notes was not available for HFA. Official Statement, \$45,000,000 State of New York Serial Bonds (Pure Waters) 37 (1976).

121. Act of March 15, 1976, ch. 38, §§ 22-23, 1976 N.Y. Laws 1 (codified at N.Y. PRIV. HOUS. FIN. LAW § 47(5)(c) (McKinney 1976)). The cap was set at a level sufficient to enable the authorities to complete all projects for which commitments had been made (including deposits to the Debt Service Reserve Fund) with a small reserve for contingencies. HFA's and MCFFA's hospital and nursing home "moral obligation" financings were capped at \$1.156 billion out of a total authorization of \$3.950 billion. *Id.*

122. N.Y. PUB. AUTH. LAW § 50 (McKinney Supp. 1978). The Public Authorities Control Board was also empowered to review and approve proposals by certain other authorities to incur additional "moral obligation" debt. *Id.*

for their projects.¹²³ HFA's first public sale of Hospital and Nursing Home Program bonds was in October 1977 for approximately \$236 million at 6.99 percent.¹²⁴ In addition to the revenues of the projects, a one year debt service reserve fund and the "moral obligation" of the state, these bonds were backed by a new \$12 million state appropriation for a special reserve fund available to the bondholders, in the event a project is unable to pay its debt service, prior to the debt service reserve fund or the state's "moral obligation."¹²⁵ This level of security was added to attract investors and to assure them of the state's commitment to its authorities.

Through this period, it became evident that the investment community closely identified the state with its authorities and municipalities because they accounted for a substantial portion of the outstanding state and state-related debt. As a result, the financial stability of the state itself was closely tied to that of its authorities.¹²⁶ Indeed, the financial difficulties of the authorities had major ramifications for the state's own ability to enter the financial marketplace and for the interest rate it had to pay. Specifically, the state annually borrows over \$3.5 billion on a short-term basis. In 1975, it was all sold publicly at an interest rate of 5.26 percent;¹²⁷ in 1976, only approximately \$2.75 billion was sold publicly at an interest rate of 7 percent.¹²⁸ Clearly, the state had to supervise the financing activities of its authorities if it was to maintain its own financial viability.

The response of the state and its authorities to the fiscal crisis in New York explains the hiatus in new hospital commitments from 1975

123. By April 1979, the outstanding permanent financing needs of the four authorities—HFA, MCFFA, Dormitory Authority, and EFC—were reduced from \$2.6 billion to less than \$1.0 billion. Preliminary Official Statement, *supra* note 113, at 36. This was accomplished by the public sale of bonds, the sale of individual projects on a revenue bond basis (with or without federal insurance in the case of housing projects), the substitution of private financing, and the permanent suspension of projects. For a discussion of the reentry of New York state and its authorities into the market, see FIRST ALBANY CORP., MUNICIPAL RESEARCH REPORT, NEW YORK STATE: AN EXAMINATION OF AN IMPROVING CREDIT (1977).

124. Official Statement, \$236,445,000, New York State Housing Finance Agency Hospital and Nursing Home Project Bonds, 1977 Series A (October 6, 1977). The first issue for any program was in September 1976. Official Statement, \$149,065,000 New York State Housing Finance Agency, 9% State University Construction Bonds, 1976 Series B (September 16, 1976).

125. Official Statement, \$236,445,000, New York State Housing Finance Agency Hospital and Nursing Home Project Bonds, *supra* note 124, at 4, 38-39.

126. Official Statement, \$45,000,000 State of New York Serial Bonds (Pure Waters), *supra* note 120, at 35.

127. New York State Dep't of Audit and Control, Internal Memorandum (undated) (copy on file in office of the *North Carolina Law Review*).

128. Official Statement, \$2,750,000,000, State of New York, 7% Tax and Revenue Anticipation Notes (April 15, 1976).

to 1978, illustrates the ongoing interrelationships between tax-exempt financing for hospitals and for other purposes in the state, and provides the framework for decisions about future hospital financings. The tax-exempt financing programs had successfully encouraged the construction, renovation and modernization of hospitals in the state and provided loans with significantly lower interest rates than would have otherwise been available. HFA, MCFFA and the Dormitory Authority had never (nor have they since) defaulted on a hospital or nursing home bond or note. Nevertheless, the initiation of new projects was entirely cut off for three years. As a representative of a major investment firm commented when discussing the future of hospital financing in New York:

[T]he effect that we learned, or should have, in 1975 and 1976, was that confidence is more or less indivisible within a state. To the extent that the state or any of its instrumentalities is perceived to be in trouble, all of them will suffer in the marketplace to some degree . . . as the Bible observes, the rain falls on the just and the unjust alike.¹²⁹

The moratorium on state authority hospital financing resulted in a dramatic shift toward the use of the FHA 242 insurance program in the state. As noted above, prior to 1976, only two New York hospitals received insurance valued at \$12 million.¹³⁰ Then, in 1976 alone, however, twelve hospitals received insurance valued at \$290 million. This was almost half of the insurance issued nationwide in 1976, and it exceeded the nationwide dollar value in any preceding year.¹³¹ This shift away from tax-exempt financing resulted in interest costs that were higher than might have been expected with tax-exempt bond financing and, therefore, in higher reimbursements rates paid by third-party payors and consumers of health care.

The upsurge of FHA 242 financing in the state did not, however, fully meet the needs of hospitals in New York.¹³² Many turned to commercial lenders and others deferred construction until they could obtain a financing source. In 1978, the state, responding to the needs of the hospitals, began to consider reactivating its tax-exempt hospital financing program.¹³³ The concerns of the state health care officials

129. Rousseau, *supra* note 112, at 18.

130. ICF INC., *supra* note 12, at 68 (Table B-3).

131. *Id.*

132. For an assessment of the relative merits of various methods from the hospital's perspective, see AMERICAN HOSPITAL ASSOCIATION, CAPITAL FINANCING FOR HOSPITALS 37-49 (1978).

133. During 1978, the Dormitory Authority accomplished two financings by combining the FHA 242 insurance, Government National Mortgage Association participation and tax exemption at a total value of approximately \$46 million. As explained above, this mechanism poses no

were summarized in a letter to HFA in August 1978:

[I]nsofar as the HFA and MCFFA program is concerned, I believe that it is both wise and necessary that we initiate new mortgage loans. While there is generally an oversupply of acute care beds in the State as a whole, many needed hospitals are operating in nonconforming structures which must be renovated if they are to meet safe structural standards and are to be available for future use. It would appear that the [HFA and MCFFA] program could serve as a vehicle to finance necessary renovations, at a relatively low cost, and where the opportunity avails itself, realign bed capacity of the institutions with projected long-range requirements.¹³⁴

These concerns regarding the health care system were, necessarily, weighed against the lessons of the fiscal crisis and the concerns of the financing authorities and the Public Authorities Control Board about further direct or indirect extension of the state's credit. Financing priorities must be set, and the decisions regarding financing hospitals must be made relative to other equally worthy projects. Potential competitors include State University construction, a convention center for New York City, economic development projects and housing.

The state, nonetheless, has decided to pursue additional hospital financing on a limited basis. The Public Authorities Control Board adopted a general framework for financing by HFA, MCFFA and the Dormitory Authority.¹³⁵ The authorities are required to cooperate closely with the Department in project selection and evaluation in an attempt to assure that projects receiving financing are consistent with the state's health planning objectives. HFA and MCFFA had historically used this approach; the Dormitory Authority, however, must adjust its procedures. Hospitals are also required to provide significant equity—ten percent of development costs—to demonstrate their commitment to the project and financial capacity to generate such funds. Finally, capital construction projects must pass a stringent review of financial feasibility. Hospitals will be required to demonstrate that

financial risk to the state or the Authority. See note 46 and accompanying text *supra*. In addition, the Dormitory Authority completed one refinancing for a project that had been in the midst of processing in 1975 when the market collapsed. Private Placement Memorandum, Dormitory Authority of the State of New York, Revenue Bonds, Charles S. Wilson Memorial Hospital Issue, Series A (Sept. 27, 1978).

134. Letter from Richard Berman, Director, Office of Health Systems Management, State of New York Dep't of Health, to Robert Vagt, Executive Director, New York State Housing Finance Agency (Aug. 15, 1978) (copy on file in the office of the *North Carolina Law Review*).

135. Instructions to Staff regarding the Review of Health Care Financing Applications (resolution included in the minutes of the May 16, 1979 Public Authorities Control Board meeting) [hereinafter cited as Instructions to Staff] (copy on file in the office of the *North Carolina Law Review*).

they are needed, not only on the basis of statewide or local planning standards, but also on the basis of the actual demand for the institution by physicians and patients within their service area. In addition, hospitals must demonstrate that they have sufficient economic resources and managerial skills to operate on a financially sound basis.¹³⁶

The specific details of HFA's and MCFFA's financing program have been modified to reflect the statutory and programmatic changes emanating from the fiscal crisis. Specifically, the bonds can be backed only by the revenue of the project, not the "moral obligation" of the state. Therefore, as a practical corollary, the bonds can only be issued for an individual project rather than a pool of projects. In addition, no notes will be issued for construction financing.¹³⁷ The Dormitory Authority did not need to modify its financing approach, which historically involved individual project revenue bonds.

New York authorities are now able to undertake financing for certain projects on a limited basis but are not in a position to assist less secure projects through the "moral obligation" provision as they have in the past. There is a need for a supplemental federal program, perhaps a targeting of the FHA 242 program or a direct grant program, to assure that projects that provide needed hospital services to communities in the state are able to obtain the financing needed in order to continue operating, maintaining their physical plants and providing high quality medical care.

IV. POLICY IMPLICATIONS

This review of capital financing for hospitals provides insights into the interrelationship between hospital capital financing programs and the federal and state governments' long-range health goals of assuring access to care for all citizens, maintaining a high standard for quality of care and bringing the rapid escalation of health care costs under control. Moreover, the New York State experience demonstrates how, at the state and local level, hospital financing interlocks with the financing of other public purpose projects. This review provides a framework for

136. Conditions for New York State Housing Finance Agency, New York State Medical Care Facilities Finance Agency, Hospital Renovation Projects, Noninsured Project Revenue Bonds, and New York State Housing Finance Agency, New York State Medical Care Facilities Finance Agency Financial Feasibility Study Guidelines, adopted by the Members of the New York State Housing Finance Agency on February 23, 1979.

137. Instructions to Staff, *supra* note 135, at 1. The concern with note financing is reflected in the requirement that HFA and MCFFA refrain from entering into any new commitments until substantially all their notes are converted into bonds.

assessing existing capital financing programs and evaluating new proposals to assure that their objectives are realistic, their anticipated outcomes are consistent with stated goals and their expectations for participation at the state and local level are appropriate.

Both state and federal governments agree on the three overall goals stated above, with the federal and some state governments placing particularly high priority, at the present time, on controlling health care costs.¹³⁸ Yet there is little consensus on the specific steps required to achieve these goals. Capital financing for the construction of new hospitals and maintenance of existing ones has implications for all three health policy goals. Capital funds are needed for the construction of new facilities and the renovation of existing ones to improve access to care in underserved areas. Furthermore, to assure that the care they provide is of high quality, hospitals in all areas must maintain their physical plants and periodically upgrade their equipment to reflect technological advances. Finally, capital expenditures affect the cost of health care directly through interest, amortization and other construction related costs. Indeed, the potential for reducing interest costs is the most commonly cited reason for government intervention in hospital capital financing. Moreover, capital expenditures can have an indirect effect through associated changes in hospital operating costs. For example, the construction of a new service such as a neo-natal unit would result in an increase in the intensity and sophistication of the services provided and a concomitant adjustment in equipment, supplies and staffing. Even when a service such as a surgical suite is merely replaced, there is often upgrading, with related increases in operating expenses. Conversely, construction changes may, in some situations, cause a net reduction in costs through increased efficiency.

Most efforts at controlling capital expenditures have relied on the health planning process to weigh the potential advantages and limitations of particular proposals and to control the number and scope of approved projects.¹³⁹ This might be sufficient if such programs were themselves well thought out and effective. Unfortunately, in many cases they are not.¹⁴⁰ Furthermore, the method of financing proposed projects has generally been overlooked by planning programs, and the potential power of government financing programs in reinforcing health planning objectives has not been adequately explored. This is

138. *See generally* Wing & Siltan, this Symposium.

139. *See generally* Wing & Craige, this Symposium.

140. *See generally* Schonbrun, this Symposium.

indicative of the fragmentation and lack of coordination in virtually all health regulatory activities today.

Orchestrating a coordinated effort may be difficult because the government participants themselves have different orientations and are responsive to different constituencies. State health planning officials must respond not only to their professional concerns regarding health needs, but also to the interest of local health planning groups, state-wide health planning advisory councils, individual hospitals and, in some cases, the state legislature, governor and other political forces. State financing authorities usually report to independent boards, are concerned primarily with protecting the interests of existing bondholders and often interact more frequently with members of the financial community than with health planning officials. HEW officials are responsible to their own regional administration and the central administration in Washington, and this may lead to conflicts with the objectives of local and state planners.

Nonetheless, government financing has significant potential as a mechanism to reinforce planning objectives and to coordinate various government efforts. In New York, for example, many areas of the state have excess hospital bed capacity, and the state health planning policy emphasizes mergers and consolidations. Government financing could be made available on a priority basis to assist and encourage such proposals. In addition, hospitals in underserved, low-income areas, which have been unable to generate extra reserves because they have incurred ambulatory care deficits and bad debts of significant size, and new or relocated hospitals, which have no financial track record, have difficulty obtaining financing from nongovernmental sources, despite their importance to the provision of health care. Government financing can assist such institutions in two ways: relatively low requirements for equity contributions enable hospitals to qualify even though they have limited capacity to generate cash contributions, and lower interest costs make demonstration of financial feasibility less difficult. In cases in which tax-exempt revenue bonds are still not marketable, FHA 242 insurance could be used. If even this option is not viable, direct subsidies may be necessary.

Government financing can also be used to discourage or modify projects that are, on detailed review, not feasible or that slip through the certificate of need process. This can be accomplished because financing provides a tool for additional screening and for controlling the construction program. Certificate of need provides a preliminary

screen of the need within the community for the proposed project. Financing, however, usually brings with it more careful scrutiny, such as an in-depth evaluation of the demand for services and of projected financial performance by an independent financial feasibility consultant.

On the other hand, there are certain potential drawbacks to government financing. At a time of acknowledged excess capacity in many areas of the country, including significant portions of New York, the ready availability of government financing may tend to encourage unnecessary expansion. Expansion will be particularly likely when hospital financing is not carefully aligned with health planning activities or when health planning requirements are not sufficiently articulated or enforced, and somewhat lower priority, but politically powerful projects are likely to be approved.

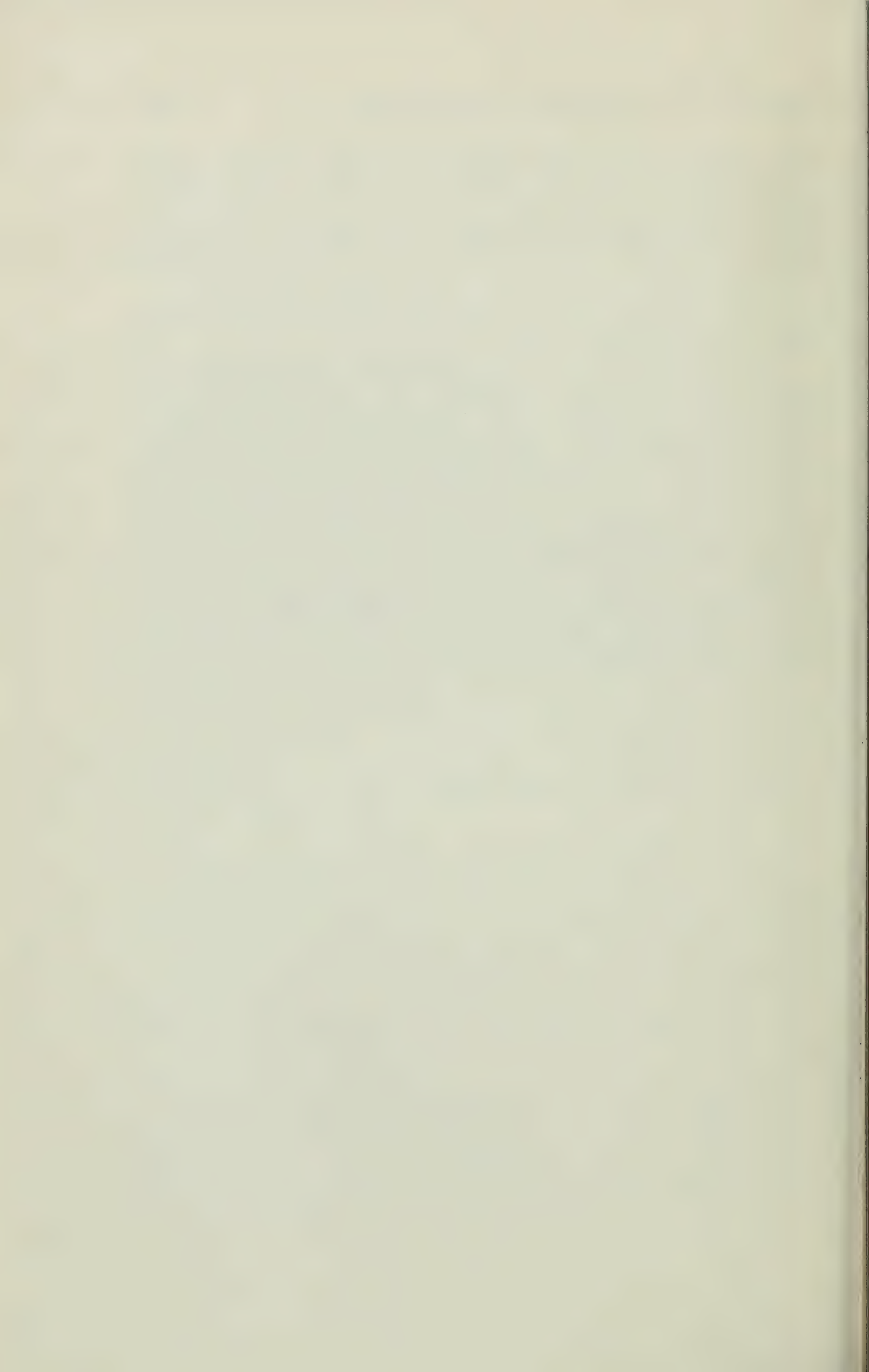
To the extent that government financing encourages excess construction, the savings on individual projects resulting from lower interest rates may be more than offset by the costs of unnecessary construction as well as any associated increases in operating costs. Unnecessary construction can take two forms—entire projects that would not otherwise have been built, and increments of projects permitted either by the more easily met governmental financing requirements or by ineffective review of the need for or cost effectiveness of the increments by government officials. Indeed, it could be argued that government financing removes projects from the scrutiny of the private capital market where financial feasibility must be clearly demonstrated and places it in a more political arena.

Rather than assist projects that would not otherwise be constructed, government financing may merely substitute for commercial mortgages issued in the private market. In fact, the financings accomplished through government to date have not been targeted to projects that could not receive financing without such assistance. HEW has not based its processing of FHA 242 applications on local health planning priorities, and state authorities have directed their programs to the hospitals that are financially secure. As a result, certain projects may have no available source of financing.

The federal or state government assumes a risk by extending its credit, either directly or indirectly. For the federal government, a default may not affect marketing of other issues. For a state, however, the ramifications can be severe. A default on a single hospital project would have limited effect, but a series of defaults could have negative

repercussions in the market for other issues of the authority or, if the situation became sufficiently severe, as the New York experience demonstrated, for the state itself. Furthermore, as a corollary, government financing may come into conflict with future cost containment efforts if such efforts would jeopardize the financial feasibility of a state authority financed or a federally insured project. There would, unquestionably, be reluctance to undertaking a cost containment strategy that would precipitate a default.

The federal and state governments should reassess the role of their hospital capital financing programs as they pursue their long-term health care goals of access, quality and cost containment. The preceding discussion demonstrates that states should be aware of the potential risks, as well as the immediate advantages of tax-exempt financing. The federal government should consider focusing its efforts on hospitals that provide necessary care but pose a greater financial risk than the private market is willing to accept, and the states are able to absorb. Together, the state and federal governments should consider a closer coordination among planning programs, financing programs and other related activities to ensure that both state and federal financing programs achieve the objectives for which they are designed.



CONSTITUTIONAL AUTHORITY FOR EXTENDING FEDERAL CONTROL OVER THE DELIVERY OF HEALTH CARE

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When Jimmy Carter took office in January 1977, he promised the nation that he would establish a number of programs to cure its economic ills, including a program of comprehensive national health insurance.¹ His promises were not unexpected: by the mid-1970s, inflation in general, and the inflating cost of health care in particular, had become major political issues in national elections.² Two years

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1. See, e.g., Presidents Remarks and Question-and-Answer Session with Employees of the Dept of Health, Education and Welfare, 13 WEEKLY COMP. OF PRES. DOC. 200, 202-03 (Feb. 16, 1977) for an early statement on the economy and health.

2. Various polls have indicated the rising political importance of the health care costs inflation issue. A recent survey indicated that the general public found hospital care and doctors' fees to be the first and third most inflationary items in the typical household budget. LOUIS HARRIS & ASSOCS. INC., HOSPITAL CARE IN AMERICA 66 (1978). The same two items were considered the most overpriced by the public and by those members of Congress who serve on health-related committees. *Id.* Although doctors recognized the dramatic rise of hospital costs, only 27% felt that those costs were overpriced, and only 5% thought their own fees were overpriced. *Id.*

The need for comprehensive health care reform has been discussed and proposed in a myriad of forms over the past thirty years. The last two Republican Administrations felt the pressures of rising health care costs, and both announced their support for some form of health care reform. In his first Administration, President Nixon sent a strong message to Congress on health care reform, which included an endorsement for prepaid health insurance payments and national health insurance. Special Message to Congress Proposing National Health Strategy, PUB. PAPERS: PRESIDENT NIXON 170 (1971). After more than two years of study, Caspar Weinberger, Secretary of HEW, finally unveiled the Nixon Administration's limited version of national health insurance. Remarks of HEW Secretary Caspar W. Weinberger at News Conference, 9 WEEKLY COMP. OF PRES. DOC. 1451 (Dec. 10, 1973).

President Ford also expressed his support for national health insurance. See Address to a Joint Session of Congress, PUB. PAPERS: PRESIDENT FORD 6, 10 (1974). As the federal budget expanded and inflation increased, however, President Ford indicated that he could no longer support a national health insurance proposal. See State of the Union Address by Gerald Ford to a Joint Session of Congress, 12 WEEKLY COMP. OF PRES. DOC. 43, 48 (Jan. 19, 1976). See also President Carter's Remarks at the Clinton Town Meeting, 13 WEEKLY COMP. OF PRES. DOC. 358,

later, however, President Carter's promise to enact national health insurance had to be revised in the face of political reality and in light of the recognition that an extension of governmentally financed health insurance would require a significant and unpopular increase in federal government spending, which would most likely increase the rate of inflation rather than mitigate its impact.³ The Administration is still offi-

365 (Mar. 16, 1977); Conversation with President Carter by Network Correspondents, in Washington, D.C., 13 WEEKLY COMP. OF PRES. DOC. 1941, 1948 (Dec. 28, 1977).

President Carter has repeatedly avowed his support for comprehensive national health insurance during his presidency; see note 1 *supra*. As the Carter Administration has developed various reform proposals in other policy areas, however, the Administration's formal introduction of national health insurance has been repeatedly delayed. See President Carter's Remarks at the United Auto Works Convention in Los Angeles, Cal., 13 WEEKLY COMP. OF PRES. DOC. 724, 730-31 (May 17, 1977) (delayed to early 1978); Question-and-Answer Session with President Carter in Yazoo, Miss., 13 WEEKLY COMP. OF PRES. DOC. 1070, 1081 (July 21, 1977) (delayed to early 1978); Question-and-Answer Session with President Carter in Bangor, Maine, WEEKLY COMP. OF PRES. DOC. 344, 347-348 (Feb. 17, 1978) (delayed to late 1978); The President's News Conference, 14 WEEKLY COMP. OF PRES. DOC. 1322, 1325 (July 20, 1978) (delayed to 1979). Furthermore, as other economic issues and budgetary constraints came to dominate the President's agenda, his original vision of national health insurance became more limited. See Question-and-Answer Session with President Carter in Spokane, Wash., 14 WEEKLY COMP. OF PRES. DOC. 860, 876-877 (May 5, 1978); Question-and-Answer Session with President Carter in Fort Worth, Texas, 14 WEEKLY COMP. OF PRES. DOC. 1157, 1160-1161 (June 23, 1978).

See note 4 and accompanying text *infra* for the latest national health insurance proposal, and notes 5 & 6 *infra* for reactions to the proposal.

3. Lead Agency Memorandum on A National Health Program, from the United States Department of Health, Education and Welfare to the President of the United States (Apr. 3, 1978) [hereinafter cited as Lead Agency Memo]. The initial proposals by HEW contained four options from which the administration could choose its plan for national health insurance. The options varied in scope, coverage, role given to government, and cost—giving the President choices ranging from a truly nationalized, comprehensive plan to limited options that were obviously intended to be far less expensive and controversial. Indeed, by proposing a series of options, the HEW proposal effectively delayed the Administration's final choice of a health insurance strategy while the alternatives were being considered. See note 4 *infra* for Carter's final decision.

The following is a brief discussion of each option:

- (1) The Consumer Choice Health Plan is "essentially a plan for federal funding of a privately administered health care financing and delivery system regulated by market forces and competition." Lead Agency Memo, *supra*, at 13-14. The government would provide vouchers (for the poor) or tax credits for the purchase of federally approved prepaid group plans, which would compete with existing private insurance plans. The consumer would choose whether to use his federal support to join a prepaid plan or purchase private insurance. *Id.* at 13-16, Tab A at 1-7.
- (2) The Target Plan aims at creating programs that would (i) reformulate and improve on Medicare and Medicaid, (ii) establish catastrophic insurance for all citizens, (iii) improve preventive and health maintenance services for children and (iv) establish standards for private insurers, who would continue to provide a majority of insurance coverage. In short, the Target Plan attempts to fill in the gaps in our present system of health care financing. *Id.* at 17-21, Tab B at 1-6.
- (3) The Quasi-Public Corporation would be created to administer national health insurance by replacing private insurance for any services covered by the program. The Corporation would receive federal funds and private premium payments to pay approved providers for services received by any resident. *Id.* at 21-24, Tab C at 1-6.
- (4) Publicly Guaranteed Health Protection would be a universal, public sector national health insurance plan, which would allow employers and individuals to opt out by purchasing insurance from federally approved private companies. The plan would be funded by premiums and taxes. *Id.* at 24-27, Tab D at 1-6.

cially committed to the enactment of some form of national health insurance, but Carter's latest proposal⁴ envisions a program that would be something far less than comprehensive insurance and that would be implemented gradually over the next decade.⁵ Even this proposal faces substantial political opposition from the provider community⁶ and a cost-conscious Congress.⁷

None of these plans is particularly unique. The Consumer Choice Health Plan is similar to the plan announced in President Nixon's message to Congress of February 18, 1971 endorsing the creation of health maintenance organizations. See Message to Congress from Richard Nixon, February 18, 1971, PUB. PAPERS: PRESIDENT NIXON 170 (1971). Catastrophic insurance, similar to that included in the Target Plan, has been proposed by Senator McIntyre. See S. 5, 95th Cong., 1st Sess., 123 CONG. REC. S159 (daily ed. Jan. 10, 1977). The Quasi-Public Corporation and Publicly Guaranteed Health Protection Plans are very similar, except that the former would be run by a quasi-governmental entity and the latter would be operated by the government. For a similar comprehensive proposal introduced by Senator Edward Kennedy, see S. 3, 95th Cong., 1st Sess., 123 CONG. REC. S158 (daily ed. Jan. 10, 1977).

These four plans were subsequently narrowed to two plans: a Targeted Approach and a Comprehensive Approach (basically the Publicly Guaranteed Health Protection Plan). Memorandum to the President of the United States from the Secretary of Health, Education and Welfare, Joseph Califano, The Basic Decision in Developing a National Health Insurance Plan (May 22, 1978) (copy on file in the office of the *North Carolina Law Review*).

4. The President finally announced his principles for national health insurance on July 29, 1978: the principles were a severe disappointment to political liberals, but clearly did not satisfy traditional opponents of national health insurance. While the President continued to assert the need for a comprehensive program, he did not set forth any specifics. He opted instead to gradually phase in the program as economic conditions warranted. The ten principles are as follows:

- (1) The plan must be comprehensive.
- (2) The plan must provide quality care.
- (3) The plan must provide freedom of choice in selecting medical care.
- (4) The plan must include strong methods of cost containment.
- (5) The plan should attempt to offset its costs through improved efficiency.
- (6) The plan should be phased in gradually.
- (7) The plan should be funded through multiple sources.
- (8) The plan should include a significant role for the insurance industry.
- (9) The plan should promote reforms in health care delivery.
- (10) The plan should include consumer representation.

Presidential Directive on a National Health Plan to the Secretary of Health, Education and Welfare 3-4 (July 29, 1978) (copy on file in the office of the *North Carolina Law Review*).

5. Senator Edward Kennedy and other liberals favor a strong and comprehensive national health insurance plan with immediate and unconditional implementation. See note 233 *infra*.

6. While the American Medical Association (AMA) has traditionally been opposed to any form of publicly-financed health insurance (for example, the AMA actively opposed Medicare legislation), in recent years the AMA has endorsed the concept of a national health insurance plan and has focused its opposition toward aspects of proposals that involve government control over the services financed. See, e.g., Statement of James H. Sammons, AMA Executive Vice President, AMERICAN MEDICAL NEWS, March 23, 1979, at 4. According to a 1979 poll, for the first time a majority of physicians (54%) see a need for some kind of national health insurance—but only in a limited, rather than a comprehensive, form. AMERICAN MEDICAL NEWS, March 2, 1979, at 9.

7. For example, in June 1979, in response to Carter's proposal, Representative Al Ullman, Chairman of the House Ways and Means Committee, announced his own NHI proposal. Ullman's plan would require no additional federal spending, encourage enrollment in health maintenance organizations, limit federal tax deductions for medical expenses and require employers to offer a choice of insurance plans. HOSPITAL WEEK, June 15, 1979, at 2.

The overall health care policy that is now being formulated by the Carter Administration has a significantly different emphasis as well. President Carter's legislative program for the Ninety-Fifth Congress included several programs intended to control the costs of Medicaid and Medicare, revisions in existing health planning legislation, recommendations to increase the regulatory authority of health planning agencies, and a proposal for direct hospital cost containment.⁸ Carter introduced several proposals that would increase federal spending for health services, but these were decidedly minor in nature.⁹ More significantly, in November 1978, the Administration announced that the proposed budget for fiscal year 1980 would include substantial cuts in many existing health programs.¹⁰ At the same time, under existing statutory authorization, the Administration has become much more cost

8. The President's agenda for health care centered on the economic issues, with limited attention paid to new health care programs. Aside from his long-term goal of national health insurance, the President enumerated a number of short-term goals, including the establishment of community mental health centers, the creation of an immunization program, administrative creation of the Health Care Finance Administration, a program attacking fraud and abuse in Medicare and Medicaid programs, the creation of incentives for additional rural health care under Medicare and Medicaid, passage of hospital cost containment legislation and passage of the Child Health Assessment Program. State of the Union Annual Message to the Congress, 14 WEEKLY COMP. OF PRES. DOC. 98, 103 (Jan. 19, 1978).

Of this agenda, Congress passed only three bills: The Rural Health Clinic Services Act, Pub. L. No. 95-210, § 1(i), 91 Stat. 1485 (1977) (codified at 42 U.S.C.A. § 1395aa (West Cum. Supp. 1978)), Medicare-Medicaid Antifraud and Abuse Amendments, Pub. L. No. 95-142, 91 Stat. 1175 (1977) (codified in scattered sections of 42 U.S.C.A. (West Cum. Supp. 1978)), and Mental Health Community Centers Extension Act, Pub. L. No. 95-622, 92 Stat. 3412 (1978) (codified in scattered sections of 42 U.S.C.A. (West Cum. Supp. 1979)). All three bills, however, were broadly sponsored.

In areas where the Administration attempted to exert its political muscle, the results were poorer. The Child Health Assessment Act (CHAP), S. 1392, 95th Cong., 1st Sess., 123 CONG. REC. S6408 (daily ed. Apr. 26, 1977) failed to pass. In addition, the Health Planning Amendments, S. 2410, 95th Cong., 2d Sess., 124 CONG. REC. S244, S246-S254 (daily ed. Jan. 23, 1978) failed to clear the House, 124 CONG. REC. H10005 (daily ed. Sept. 18, 1978), after being passed by the Senate, 124 CONG. REC. S11905-S11953 (daily ed. July 27, 1978). Without the passage of either S. 2410 or H.R. 11488, the authorization for the planning program lapsed as of September 30, 1978. 42 U.S.C.A. §§ 3001-5(c)(1); 300m-4(c); 300m-5(e); 300n-2(d); 300p-3 (West Cum. Supp. 1977). The program has continued to operate, however, under a general continuing resolution. Pub. L. No. 95-482, 92 Stat. 1603 (1978). Hospital cost containment failed to pass the House, although it did pass the Senate. 124 CONG. REC. S18328 (daily ed. Oct. 12, 1978). For a description of this proposal and its fate in Congress, see text accompanying notes 39-50, 66-71 *infra*.

9. See, for example, S. 1392, 95th Cong., 1st Sess., 123 CONG. REC. 6408 (daily ed. April 26, 1977) for the Child Health Assessment Program (CHAP), a program designed to replace Medicaid's Early and Periodic Screening, Diagnosis and Treatment Program, 42 U.S.C. § 1396d(a)(4)(B) (1976), by extending \$1.8 billion in aid to encourage an improved effort to provide health care for poor children.

10. In the fall of 1978, President Carter had indicated that his proposed budget for fiscal year 1980 would substantially cut back the federal health spending. See WASHINGTON REP. ON MED. & HEALTH, December 4, 1978, at 1. His final proposed budget was more moderate but generally held spending at current levels with modest increases in a few programs. For a summary of the proposed federal health budget, see HEALTH SYSTEMS REP., January 26, 1979, at 1-12.

conscious in its Medicaid and Medicare reimbursement determinations¹¹ and its administration of related regulatory programs.¹² In summary, the Administration's short-term strategy is emerging: limited and perhaps reduced federal spending for health care, increased efforts

11. Two areas in which HEW has attempted to be more cost conscious are the capital recapture regulations, 42 C.F.R. § 405.415(d)(3) (1977), and the multiple source drug regulations (MAC), 45 *id.* § 19.1-.6 (1977). The recapture regulations recoup excessive amounts of depreciation taken by providers that withdraw from Medicare and Medicaid or have a substantial decline in their patient mix. The MAC regulations attempt to limit federal reimbursement for multiple-source prescription drugs. For cases upholding the recapture regulations, see *Summit Nursing Home, Inc. v. United States*, 572 F.2d 737 (Ct. Cl. 1978); *Adams Nursing Home, Inc. v. Mathews*, 548 F.2d 1077 (1st Cir. 1977); *Springdale Convalescent Center v. Mathews*, 545 F.2d 943 (5th Cir. 1977); *Hazelwood Chronic & Convalescent Hosp. Inc. v. Weinberger*, 543 F.2d 703 (9th Cir. 1976), *vacated* 430 U.S. 952 (1977). The MAC regulations were upheld in *American Medical Ass'n v. Mathews*, 429 F. Supp. 1179 (N.D. Ill. 1977).

For other cost containment regulations, see 20 C.F.R. § 405.486(b)(1) (1975) (allowing recapture of excess rental costs). This regulation was upheld in *Vallejo Gen. Hosp. v. Weinberger*, [1978 Transfer Binder] *MEDICARE & MEDICAID GUIDE* (CCH) ¶ 28,373 (N.D. Cal. 1977).

12. In the National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, § 3, 88 Stat. 2227 (codified at 42 U.S.C. § 300k-1 (Cum. Supp. 1977)), the Congress authorized HEW to establish planning guidelines that would set standards and goals for the allocation of the nation's health resources.

The first set of proposed guidelines, which were published September 23, 1977, 42 Fed. Reg. 48,502 (1977), dealt with the availability and utilization of some inpatient hospital services. After receiving over 10,000 comments, HEW republished its proposed rules utilizing less stringent standards while permitting greater discretion to the health systems agencies (HSAs). 43 Fed. Reg. 3056 (1978) (codified in 42 C.F.R. § 121.1 through .211 (1978)). Both sets of proposed guidelines established standards for inpatient hospital bed supply, hospital occupancy rates, obstetrical services, pediatric inpatient services and occupancy, neonatal intensive care, open heart surgery, cardiac catheterization, radiation therapy, computed tomographic (CT) scanners and end-stage renal diseases.

The weakening of the standards can be illustrated by the radiation therapy and CT scanner standards. The proposed radiation therapy standards mandated that each unit in an HSA should serve a population of 150,000 persons or 450 new cancer patients per year, and that no new facility should be authorized unless each existing unit performed 7,500 treatments per year. 42 Fed. Reg. 48,505 (1977). The revised guidelines retained the 150,000 persons population requirement, but softened the second requirement by reducing the number of cancer patients per unit to 300 and removing the requirement that they be *new* cancer patients. Furthermore, the standard for the authorization of a new radiology unit was dropped to 6,000 procedures per year per unit with a downward adjustment if significant portions of the relevant population have substantial travel time. 43 Fed. Reg. 3068 (1978) (codified in 42 C.F.R. § 121.209 (1978)).

The CT scanner standards originally prescribed a minimum of 2,500 procedures per year per unit, coupled with the requirement that no new unit be authorized unless all the units in an HSA were performing more than 4,000 procedures per year per unit. In addition, the original guidelines attempted to set cost standards that would have required that charges for each unit be set as if it were performing a minimum of 2,500 procedures per year. 42 Fed. Reg. 48,505 (1977). While the minimum standard of 2,500 procedures per year per unit was maintained, the standard for authorizing new units was reduced to 2,500 procedures per year per unit, and the cost standards were dropped altogether. 43 Fed. Reg. 3067 (1978) (codified in 42 C.F.R. § 121.210 (1978)).

Perhaps the largest overall weakening effect will be felt as a result of the establishment of an adjustment procedure under which HSAs can adjust any federal standard to meet *special needs or conditions*, and still comply with the guidelines. 43 Fed. Reg. 3064 (1978) (codified in 42 C.F.R. § 121.6 (1978)).

at controlling inflation, including several regulatory programs of an unprecedented nature, and deemphasis of national health insurance.

I. THE DEVELOPMENT OF FEDERAL CONTROLS

The Carter Administration's regulatory strategy is a continuation of the cost-conscious approach that began under prior administrations in the early 1970s. The preceding decade had witnessed an explosive expansion of federal health care spending, providing for direct financial support for health care to the poor,¹³ the elderly,¹⁴ and other special and high risk populations,¹⁵ and underwriting a variety of new programs and institutions affecting virtually every aspect of health care delivery.¹⁶ The general thrust of these federal efforts was directed toward the identified, but unmet, health needs of many Americans.¹⁷ The approach was designed to "prime the pump" with federal dollars while minimizing governmental interference with health care providers.¹⁸ Planning programs had been encouraged and, in some cases, required¹⁹ as a prerequisite for participation in various federal programs. These programs were largely experimental, however, and arguably were never intended to have a direct regulatory impact.²⁰ Similarly, cost controls were built into the reimbursement methodology²¹ and

13. 42 U.S.C. § 1396 (1976) (Medicaid).

14. *Id.* § 1395 (1976) (Medicare).

15. The number of categorical programs is much too large to list. For a general guide to such programs, see OFFICE OF MANAGEMENT AND BUDGET, CATALOG OF FEDERAL DOMESTIC ASSISTANCE 150-224 (1978); OFFICE OF MANAGEMENT AND BUDGET, UPDATE TO THE CATALOG OF FEDERAL DOMESTIC ASSISTANCE at E-15 through E-34 (1978). See also 42 C.F.R. §§ 166-523 (1978) (compilation of grants under Public Health Service Act and other legislation).

16. For an analysis of these programs, see Wing & Craige, *Health Care Regulation: Dilemma of a Partially Developed Public Policy*, this Symposium, at text accompanying notes 148-208. See also K. DAVIS & C. SCHOEN, *HEALTH AND THE WAR ON POVERTY* (1978).

17. For the legislative purposes of Medicare, see 42 U.S.C. § 1395 (1976) (no federal interference in the practice of medicine), § 1395a (free choice of beneficiaries to select among participating providers), § 1395b (option of beneficiaries to select other insurance protection), § 1395c (establishment of hospital insurance for the aged). For the legislative purposes of Medicaid, see 42 U.S.C. § 1396 (enabling states to establish medical assistance for the poor) (1976). See also 42 U.S.C. § 1396a (1976) (describing guidelines for state plans).

18. See Wing & Craige, this Symposium, at text accompanying notes 148-54.

19. See *id.* this Symposium, at text accompanying notes 159-64.

20. Note, for instance, the deference to the private practice of medicine expressed in the preamble to the 1966 health planning legislation. Comprehensive Health Planning and Public Health Services Amendment of 1966, Pub. L. No. 89-749, § 2(a), 80 Stat. 1180.

21. See Social Security Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286 (codified in scattered sections of 42 U.S.C. (1976)). The original reasonable cost reimbursement provision is set out at 42 U.S.C. § 1395x(v)(i) (1970) (amended 1972) as follows:

The reasonable cost of any services shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services.

conditions for participation²² in Medicare and Medicaid, but these controls were virtually titular in both form and practice, and had little effect on curbing the impact of inflation that characterized both the Medicare and Medicaid programs.²³

By the 1970s, this era of expanding federal spending had ended. The problem of health care that was drawing Congress' attention was not that of unmet needs for services,²⁴ but the costs of health care services, particularly the costs of those services associated with existing federal programs.²⁵ In 1972, Congress amended the Social Security Act²⁶ to institute a number of cost controlling conditions on provider participation in Medicare and Medicaid²⁷ and to add several programs intended to regulate directly the costs of those federal programs.²⁸ Section 221 of the amendments authorized a federal "certificate of need" program,²⁹ allowing the Department of Health, Education and Welfare (HEW) to limit reimbursement under federal programs for un-

. . . Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, . . . Such regulations shall (A) take into account both direct and indirect costs of providers of services in order that, under the methods of determining costs, the costs with respect to individuals covered by the insurance programs . . . will not be borne by individuals not so covered, and the costs with respect [sic] to individuals not so covered will not be borne by such insurance programs. . . .

22. For utilization review under Medicare, see 42 U.S.C. §§ 1395h(b)(1)(B), 1395x(k)(2), 1395y(a)(2) (1976).

23. See Wing & Craige, this Symposium, at note 5.

24. See text accompanying notes 13-17 *supra*.

25. See *Social Security Amendments of 1971: Hearings on H.R. 1 Before the Senate Finance Comm.*, 92d Cong., 1st & 2d Sess. (1971-72); *Social Security and Welfare Proposals: Hearings Before the House Comm. on Ways & Means*, 91st Cong. 1st Sess. (1969); H.R. REP. NO. 231, 92d Cong., 1st Sess., reprinted in [1972] U.S. CODE CONG. & AD. NEWS 4989; S. REP. NO. 1230, 92d Cong., 2d Sess. (1972); H. CONF. REP. NO. 1605, 92d Cong., 2d Sess., reprinted in [1972] U.S. CODE CONG. & AD. NEWS 5370.

26. See *Social Security Amendments of 1972*, Pub. L. No. 92-603, 86 Stat. 1329 (codified in scattered sections of 42 U.S.C. (1976)).

27. See 42 U.S.C. §§ 1395x(k), 1396a(32)-(36) (1976).

28. For Medicare and Medicaid reforms under the Social Security Amendments of 1972, Pub. L. No. 92-603, see § 222(a) (state demonstration project for reimbursement) 86 Stat. 1390 (codified at 42 U.S.C. § 1395f (1976)); § 224(a) (limiting charge reimbursements under Part B of Medicare) 86 Stat. 1395 (codified as amended at 42 U.S.C. § 1395u(b)(3) (1976)); § 225 (limiting Medicaid reimbursements to Skilled Nursing Facilities) 86 Stat. 1396 (codified at 42 U.S.C. § 1396b(j) (1976) (repealed 1973)); § 228 (requiring advance approval for extended care and home health coverage), 86 Stat. 1407 (codified at 42 U.S.C. § 1395 (1976)); § 232 (state determination of reasonable cost under Medicaid) 86 Stat. 1410 (codified at 42 U.S.C. § 705 (1976)). For a discussion of these amendments, see H.R. REP. NO. 231, 92d Cong., 1st Sess., reprinted in [1972] U.S. CODE CONG. & AD. NEWS 5370.

29. *Social Security Amendments of 1972*, Pub. L. No. 92-603, § 221, 86 Stat. 1386 (codified at 42 U.S.C. § 1320a-1 (1976)). See also Wing & Craige, this Symposium, at text accompanying notes 180-83.

necessary capital expenditures. Requirements for utilization review were imposed on all providers participating in federal programs.³⁰ Under section 223, HEW was also authorized to impose maximum limits on allowable costs under Medicaid and Medicare—a limited but notable departure from the cost reimbursement approach that had been previously used under those programs.³¹ While there was little indication of an intent to retrench drastically on federal spending for health care,³² the 1972 amendments clearly represented an intent to limit the potential scope of federal funding for health services, most notably by expanding the discretion allowed to the states in imposing limitations on their Medicaid programs.³³

The National Health Planning and Resources Development Act of 1974³⁴ further demonstrated congressional concern for controls on health spending and an increased willingness to impose government controls on health care providers. Efforts were made to consolidate the major programs for facility construction and program development.³⁵ Additional regulatory authority was delegated to health planning agencies, including a requirement that states enact certificate of need programs and engage in a variety of planning activities as a condition for receipt of federal funding.³⁶ The role of HEW in administering the federal legislation was expanded, indicating an increased willingness to allow the federal executive a major role in administering health planning programs.³⁷

During this period the Nixon Administration, under the authority of the Economic Stabilization Program, also issued regulations for the control of prices and wages in the health care industry.³⁸ In fact, the

30. 42 U.S.C. § 1396a(a)(30) (1976); *see note 25 supra*.

31. Social Security Amendments of 1972, Pub. L. No. 92-603, § 223, 86 Stat. 1393 (codified at 42 U.S.C. § 1395x(v)(1)(A) (1976)); *see text accompanying note 62 infra*.

32. Federal appropriations for Medicare for fiscal years 1973 and 1974 amounted to \$9.0 and \$10.7 billion respectively, and Medicaid appropriations for the same period were \$4.4 and \$5.6 billion respectively. STATISTICAL ABSTRACT OF THE UNITED STATES 297 (1976).

33. Social Security Amendments of 1972, Pub. L. No. 92-603, § 223(a), 86 Stat. 1410 (1972) (codified at 42 U.S.C. § 1396(a) (1976)).

34. Pub. L. No. 93-641, 88 Stat. 2225 (codified at 42 U.S.C. § 300k (1976)).

35. *See* National Health Planning and Resources Development Act of 1974, Pub. L. No. 93-641, § 4, 88 Stat. 2257 (codified at 42 U.S.C. §§ 300o, 300p, 300q, 300r, 300s (1976)).

36. *See* 42 U.S.C. § 300m-2(a)(4) (1976). *See also* Wing & Craige, this Symposium, at text accompanying notes 186-96.

37. *See* Wing & Craige, this Symposium, at text accompanying notes 186-96.

38. Economic Stabilization Act of 1970, Pub. L. No. 91-379, 84 Stat. 799, as amended, Pub. L. No. 91-558, 84 Stat. 1468 (1970); Pub. L. No. 92-8, 85 Stat. 13 (1971); Pub. L. No. 92-15, 85 Stat. 38 (1971); Pub. L. No. 92-210, 85 Stat. 743 (1971); Pub. L. No. 93-28, 87 Stat. 27 (1973).

final phase of the Nixon program served as the model for the Carter Administration's initial proposal for hospital cost containment.

Present proposals for hospital cost containment represent an extension of this trend towards increased federal regulation of health care providers that began in the early 1970s. With a forty percent share of total health expenditures, an annual rate of inflation in excess of fifteen percent, and a dominant role in the provision of all medical services, the hospital industry is an obvious target for further regulatory controls.³⁹ Originally billed as an interim holding action to control health cost inflation until a more permanent solution could be devised⁴⁰ (presumably as part of a national health insurance scheme), hospital cost containment is now the centerpiece of Carter's regulatory strategy.

The theory underlying hospital cost containment is to control cost by imposing a ceiling on collected revenues. To implement this theory the Ninety-Fifth Congress considered two basic schemes⁴¹ from which a number of variations evolved: a comprehensive plan governing virtu-

39. Acute care hospitals represent a 40% share of total hospital expenditures and have experienced an annual rate of inflation in excess of 15% over the past several years. See Wing & Craige, this Symposium, at text accompanying notes 41-43. Thus, the Hospital Cost Containment Act was an attempt at controlling the largest and most inflationary portion of the health care cost problem.

40. President's Message to Congress Proposing Enactment of the Hospital Cost Containment Act of 1977 and the Child Health Assessment Act of 1977, 13 WEEKLY COMP. OF PRES. DOC. 603-05 (Apr. 25, 1977). See also S. 1391, 95th Cong., 1st Sess. § 101, 123 CONG. REC. S6403 (daily ed. Apr. 26, 1977), which states in part: "It is the purpose of the transitional hospital cost containment program . . . to constrain the rate of increases in total acute care hospital inpatient costs . . . until the adoption of . . . permanent reforms." (emphasis added).

41. There was, in effect, a third basic option. Under a compromise that arose during the congressional debate, authorized cost containment controls would be imposed only if voluntary efforts by the hospital industry failed to achieve specified results. This compromise was proposed after the Federation of American Hospitals, American Medical Association and American Hospital Association announced that they were forming a joint venture called the "Voluntary Effort" for the purpose of lowering the rate of increase in total hospital expenditures by 2% for 1978 and 1979, in order to reduce the gap between the rates of increase in hospital expenditures and gross national product. See Press Release by the Voluntary Effort in Washington, D.C. (Jan. 16, 1978). Obviously, however, the "Voluntary Effort" was as much a political ploy as a good-faith commitment by the industry to control costs. Nonetheless, Congress, eager to avoid a confrontation, accepted the venture at face value.

In considering the comprehensive plan, both the Ways and Means Health Subcommittee and the Interstate and Foreign Commerce Committee created a trigger mechanism: if the nation's hospitals failed to meet their voluntary goals, then the trigger would be pulled and a mandatory federal hospital cost containment program would be initiated. At various points in the congressional debate a second trigger was created: if the federal goal was not met, then HEW would have to determine on a state-by-state basis whether hospitals met the voluntary goals. See H.R. 5285, 95th Cong., 2d Sess., § 2(b), 124 CONG. REC. S18368 (daily ed. Oct. 12, 1978). In the end, the failure of Congress to press hospital cost containment left the Voluntary Effort as the only attempt at containing costs. Early indications were that the Voluntary Effort would not be successful in curbing hospital cost inflation.

ally all hospitals and all sources of revenue,⁴² and a limited proposal imposing cost containment only on Medicaid and Medicare reimbursement.⁴³

Under the comprehensive plan, total revenues for covered hospitals⁴⁴ from all sources,⁴⁵ including government programs, private insurance and out-of-pocket payments by consumers, would be limited to an

42. See HOSPITAL WEEK, April 13, 1979, at 1. The comprehensive plan was proposed by President Carter and was included in legislation sponsored by Senator Edward Kennedy, S. 1391, 95th Cong., 1st Sess., 123 CONG. REC. S6403-S6408 (daily ed. Apr. 26, 1977), and Rep. Paul Rogers, H.R. 6575, 95th Cong., 1st Sess., 123 CONG. REC. HR3546 (daily ed. Apr. 25, 1977). The original versions were modified on numerous occasions to accommodate various interests and effect political compromises. A similar proposal, the Hospital Cost Containment Act of 1979, was sent to Congress by President Carter in March of 1979. HOSPITAL WEEK, March 9, 1979, at 1.

43. The limited plan was introduced by Senator Herman Talmadge as S. 1470, 95th Cong., 1st Sess., 123 CONG. REC. S7106 (daily ed. May 5, 1977), and remained virtually unchanged until its final adoption by the Senate, when Senator Gaylord Nelson successfully merged a weak form of the comprehensive plan with the limited plan, H.R. 5285, 95th Cong., 2d Sess., § 2, 124 CONG. REC. S18329, S18394, S18408 (daily ed. Oct. 12, 1978). See note 68 *infra* for a discussion of the Nelson compromise.

44. The hospitals included under the comprehensive plan were defined as short-term acute care facilities that are not federal hospitals or health maintenance organizations. STAFF OF HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 95TH CONG., 2D SESS., SUBSTITUTE TO THE COMMITTEE PRINT OF OCTOBER 20, 1977 OF H.R. 6575 (Comm. Print 1978) [hereinafter cited as ROGERS SUBSTITUTE PRINT].

45. As originally formulated, the revenue limitation was imposed only on the inpatient portion of a hospital's budget. Thus, outpatient services were left free from federal controls. S. 1391, 95th Cong., 1st Sess., § 102(a), 123 CONG. REC. S6403 (daily ed. Apr. 26, 1977). Over 85% of hospital revenues are derived from inpatient revenues. AMERICAN HOSPITAL ASS'N, HOSPITAL STATISTICS 188 (Table II) (1978). By controlling inpatient revenues, the lion's share of hospital costs would be controlled and the relatively less expensive outpatient services would be utilized more often.

Throughout the congressional debate, the Administration's bill was slowly drained of its coverage. First, organized labor was accommodated by the exclusion or "pass-through" of nonsupervisory wage increases. Second, rural interests were protected with the exclusion of all small rural hospitals from the limitations of hospital cost containment (HCC).

The original version of HCC, as proposed by the Administration, permitted the pass-through of nonsupervisory wage increases only if the hospital administrator petitioned the secretary of HEW. S. 1391, 95th Cong., 1st Sess., § 124, 123 CONG. REC. S6403, S6406 (daily ed. Apr. 26, 1977). Organized labor, fearing that nonsupervisory personnel would bear the burden of revenue controls, attempted to exchange their endorsement of HCC for a mandatory and automatic pass-through of nonsupervisory wage increases. See SENATE COMM. ON HUMAN RESOURCES, 95TH CONG., 1ST SESS., THE HOSPITAL COST CONTAINMENT ACT OF 1977: SUMMARY AND ANALYSIS OF CONSIDERATION, 43 (Comm. Print 1977) [hereinafter cited as KENNEDY PRINT]; H.R. 5285, 95th Cong., 2d Sess., § 2(b), 124 CONG. REC. S18368 (daily ed. Oct. 12, 1978).

State administered cost containment programs that could give assurances concerning their comprehensiveness and effectiveness would have been exempted from the mandatory federal program. S. 1391, 95th Cong., 1st Sess., § 102(f), 123 CONG. REC. S6403 (daily ed. Apr. 26, 1977). As the debate continued in Congress, the standards were relaxed to permit several additional states to obtain an exemption from the federal program. See ROGERS SUBSTITUTE PRINT, *supra* note 44, at § 121. While HEW originally wanted a requirement that state programs have had significant operating experience, subsequent versions of HCC limited this requirement, and an amendment by Senator Edmund Muskie to Senator Gaylord Nelson's limited version of HCC did away with the need for any prior operating experience. 124 CONG. REC. S18380 (daily ed. Oct. 12, 1978).

increase of approximately nine percent per year⁴⁶ for each category of payor. Various adjustments to this limit are allowed for changes in number of admissions,⁴⁷ services provided or the facility's capacity.⁴⁸ If the revenue limit on either Medicaid or Medicare is exceeded in a given year, the federal government will deny further reimbursement for Medicaid or Medicare services to that hospital⁴⁹; if the limit is exceeded for private insurance or out-of-pocket payors, the plan imposes a 150% tax on any revenue collected from these sources.⁵⁰

46. The 9% limitation was derived from a number of differing formulas. Under the original Administration proposal, the allowable increase was derived from a weighted average of general inflation, determined by the gross national product (GNP) implicit price deflator (roughly 6%), and a health inflation index, to be derived by the Secretary of HEW (assumed to be about 15%). A hospital was permitted to increase revenues by the amount of the GNP implicit price deflator, plus one-third the difference between the GNP implicit price deflator and the health inflation index. S. 1391, 95th Cong., 1st Sess. § 112(b), 123 CONG. REC. S6404 (daily ed. Apr. 26, 1977). Later versions of HCC derived the 9% limitation by allowing a rate of increase equal to one and one-half times the GNP implicit price deflator. See SUBCOMM. ON HEALTH OF HOUSE COMM. ON WAYS & MEANS, 95TH CONG., 2D SESS., H.R. 6575: A BILL § 112 (Comm. Print 1978) [hereinafter cited as ROSTENKOWSKI PRINT].

47. The basic limitation on allowable increases in inpatient revenues was adjusted for moderate increases or decreases in admissions over the base year. See Lipscomb, Raskin & Eichenholz, *The Use of Marginal Cost Estimates in Hospital Cost-Containment Policy*, in HOSPITAL COST CONTAINMENT 514 (M. Zubcoff, I. Raskin & R. Hanft eds. 1978); Lave & Lave, *Hospital Cost Function Analysis: Implications For Cost Controls*, in *id.* at 538.

48. Numerous exceptions for unusual circumstances were provided to the overall limitation on increases in hospital inpatient revenues, giving HEW discretion to raise the allowable increase. Two of the exceptions permitted under the comprehensive plan are (1) major increases in capacity or services provided, and (2) major renovation or replacement of the physical plant. Under the early versions of HCC, such exceptions were provided only if the facility met an initial financial hardship test. S. 1391, 95th Cong., 1st Sess. § 115(a)(2), 123 CONG. REC. S6404 (daily ed. Apr. 26, 1977).

For further analysis of these provisions, see SENATE COMM. ON HUMAN RESOURCES, 95TH CONG., 1ST SESS., THE HOSPITAL COST CONTAINMENT ACT OF 1977: SUMMARY OF ANALYSIS AND CONSIDERATION 17 (Comm. Print 1977); STAFF OF HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., 2D SESS., SUMMARY OF H.R. 6575, AS REPORTED BY THE SUBCOMM. ON HEALTH AND THE ENVIRONMENT 11 (Comm. Print 1978).

49. The comprehensive plan permits the continuation of reimbursement under Medicare and Medicaid using interim payments and a final settlement at the end of the year. See S. 1391, 95th Cong., 1st Sess. § 116(a)(b)(c), 123 CONG. REC. S6405 (daily ed. Apr. 26, 1977), for the relationship of HCC to reimbursement under Medicare and Medicaid. Such reimbursements may not exceed the revenue increase limitation established under the comprehensive plan (i.e., roughly a 9% increase in those revenues derived from Medicare and Medicaid). See S. 1391, 95th Cong., 1st Sess. § 116(a)(b), 123 CONG. REC. S6405 (daily ed. Apr. 26, 1977).

50. The 150% tax on any charges or cost reimbursements in excess of the revenue limitation established under the comprehensive plan could be avoided by assurances to HEW of appropriate downward adjustments for the following year or establishment of an escrow account for the excess collections. The tax penalty provision remained virtually unchanged under every variation of the comprehensive plan. See S. 1391, 95th Cong., 1st Sess. § 128(a), 123 CONG. REC. S6406 (daily ed. Apr. 26, 1977).

In addition to the limit set on revenues, the original Carter proposal established a ceiling on annual capital expenditures by hospitals of \$2.5 billion. S. 1391, 95th Cong., 1st Sess. § 201, 123 CONG. REC. S6406 (daily ed. Apr. 26, 1977). Unable to justify the original \$2.5 billion limitation, the amount was increased during committee consideration until it approached \$4.0 billion. STAFF

The limited plan would establish revenue limitations only on Medicare and Medicaid reimbursement, and not on private insurers or out-of-pocket payments.⁵¹ Furthermore, rather than placing a fixed ceiling on total Medicaid and Medicare inpatient revenues,⁵² under this proposal hospitals would be grouped by size, type, location and other criteria,⁵³ and using these groups, an average group cost for routine services per patient day would be established for a base year.⁵⁴ This base year average is then increased by an inflator for each subsequent year;⁵⁵ reimbursement for routine costs would be allowed up to 120% of the hospital's group average.⁵⁶ Some versions of this plan would allow for bonus payments to hospitals with costs below their group's average.⁵⁷ Like the comprehensive plan, the limited plan would also allow a series of exceptions or adjustments for unusual circumstances.⁵⁸

All the hospital cost containment proposals anticipate an unprece-

OF HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 95TH CONG., 2D SESS., H.R. 6575 (Comm. Print 1978) [hereinafter cited as BROYHILL PRINT].

The original intention of the provision was to bolster the planning process by setting firm limitations on capital expenditures. Senator Edward Kennedy and the Senate Committee on Human Resources went further than the Carter Administration by ordering a moratorium on all capital expenditures for a specified period. See KENNEDY PRINT, *supra* note 45, at 48-50.

The ceiling on capital expenditures was to be apportioned among the states by a complex formula. The state health planning agencies were to apply the limitations within the state for expenditures involving over \$150,000 (originally \$100,000) or significant changes in capacity or services provided. Further special refinements were permitted in the state's pool of capital expenditures for hospital closures, consolidations or conversions, and any unused portion of the pool. For two versions of this proposal, see S. 1391, 95th Cong., 1st Sess. § 201, 123 CONG. REC. S6406-S6407 (daily ed. Apr. 26, 1977) and ROGERS SUBSTITUTE PRINT, *supra* note 44, at § 201.

A third major provision, added to the comprehensive plan by Rep. Paul Rogers, authorized federal expenditures to aid hospitals in the closure of beds or discontinuation of unneeded services. See H.R. 8633, 95th Cong., 1st Sess., § 502, 123 CONG. REC. H8116 (daily ed. July 28, 1977); H.R. 8121, 95th Cong., 1st Sess., §§ 301 et. seq., 123 CONG. REC. H6791 (daily ed. July 2, 1977), ROGERS SUBSTITUTE PRINT, *supra* note 44, at § 301. Discussion of this proposal is omitted from this article, because it does not raise the constitutional issues inherent in more rigorous forms of cost containment.

51. S. 1470, 95th Cong., 1st Sess., 123 CONG. REC. S7206 (daily ed. May 6, 1977).

52. Clearly, this proposal could be expanded to cover all sources of inpatient revenues. In fact, Senator Gaylord Nelson's compromise proposal simply extended the limited plan's methodology to other payors. See H.R. 5285 [S. 1470], 95th Cong., 2d Sess. § 2a(1), 124 CONG. REC. S18368 (daily ed. Oct. 12, 1978).

53. S. 1470, 95th Cong., 1st Sess. § 2(b), 123 CONG. REC. S7204-S7205 (daily ed. May 6, 1977).

54. *Id.*

55. *Id.*

56. *Id.* After S. 1470 was amended, the percentage was reduced to 115% of the group average. See H.R. 5285, 95th Cong., 2d Sess. § 2(b), 124 CONG. REC. S18329-S18330 (daily ed. Oct. 12, 1978).

57. S. 1470, 95th Cong., 1st Sess. § 2(b), 123 CONG. REC. S7106 (daily ed. May 6, 1977).

58. Exceptions are provided for "sole community providers," which are underutilized hospitals that demonstrate greater than average intensity of care or new facilities. *Id.* at S7204. See note 48 *supra* for a discussion of exceptions under the comprehensive plan.

dented expansion of the federal role in determining the cost of health care and the distribution of resources. At least under the comprehensive plan, cost containment would entail direct federal involvement in the costs of all health services, not just those that are federally financed. The adoption of this new federal posture, however, may not be entirely predicated on the enactment of specific cost containment legislation.

As mentioned above, HEW has been markedly more cost conscious in its reimbursement determinations in the last several years. Through stricter reimbursement policies, HEW has been able to increase significantly federal influence on both service costs and resource allocation by Medicaid and Medicare providers. There is also a range of other possible options for a "get tough" policy under existing statutory authorization. Existing federal involvement and control could be considerably expanded without further legislation if, for example, the discretionary authority of HEW under the 1974 health planning legislation were fully implemented.⁵⁹ While the program has yet to achieve measurable results, HEW also could exercise substantial control over new capital expenditures by virtually all hospitals and nursing homes if the "section 1122" certificate of need program were administered in a more vigorous way.⁶⁰ Similarly, the program implemented by HEW under section 223 of the Social Security Amendments of 1972⁶¹ has already imposed some cost controls that resemble in form, if not in magnitude or impact, the proposed hospital cost containment programs.⁶² These section 223 controls could also be expanded beyond

59. See note 12 *supra*.

60. See Schonbrun, *Making Certificate of Need Work*, this Symposium, at text accompanying notes 109-11.

61. See note 31 *supra*.

62. 42 Fed. Reg. 53,679 (1977). All hospitals are first divided by their location into SMSA and non-SMSA groups and then further broken down by per capita income (a proxy of area costs) into five subgroups. The other variable utilized is bed size, which creates a 20 cell schedule (5x4) for hospitals located within SMSAs, and a 15 cell schedule (5x3) for hospitals located outside SMSAs, with special provisions for Alaska and Hawaii. HEW currently applies a grouping methodology to reduce the rate of reimbursement for hospitals that have routine costs that greatly exceed those of comparable facilities. Under the current formula, a maximum routine per diem reimbursement is established at the 80th percentile of the group, plus 10% of the group average. This maximum routine per diem is then generously inflated (by approximately 14%) to establish current year limits that affect only the most expensive providers. While these regulations do not represent major constraints on costs, they do, in fact, mark the establishment of prospective rate ceilings and a departure from traditional notions of individual cost determination. Since the regulations permit full reimbursement up to the 80th percentile, plus 10% of the group average and a generous inflation factor, very few hospitals are affected. Furthermore, any amount in excess of the limitation may be charged to the beneficiary, at least under specified conditions.

At present HEW is reevaluating its per capita income variable because it has had an adverse impact in Boston, where per capita income has dropped in recent years and thus lowered allowable reimbursement to area hospitals. See Memorandum to the Under-Secretary, Hale Champion,

their present scope.

On the other hand, any attempt to further expand the federal government's regulatory role will encounter substantial political resistance. The health care industry, despite existing regulatory programs, possesses a high degree of autonomy,⁶³ and can be expected to mount an extensive campaign to prevent any further extension of federal authority. Furthermore, the traditional opposition of state and local governments to expanded federal influence will add to the difficulty of extending federal authority.⁶⁴ Thus, the political climate in the Ninety-Sixth Congress will not offer the Carter Administration fair weather for the enactment of hospital cost containment or further implementation of its regulatory strategy.

The record of the Ninety-Fifth Congress provides some insights into the political controversies that lie ahead.⁶⁵ Despite extensive Administration efforts, the Congress adjourned without enacting any major health legislation.⁶⁶ The fate of the hospital cost containment proposals is demonstrative of the political mood that prevailed. After lengthy hearings in both houses and consideration of a variety of cost containment strategies,⁶⁷ not even the weakest version of hospital cost

from the Administrator of the Health Care Finance Administration on Section 223 (Apr. 5, 1978) (copy on file in the office of the *North Carolina Law Review*).

If rigorously applied, the broad mandate contained in § 223 could result in a significant increase in federal control and in a much stricter form of cost containment. For example, HEW could expand § 223 to cover more than the routine portion of hospital costs, to include institutions in addition to hospitals or to utilize a more stringent methodology for determining reimbursement.

63. See Wing & Craige, this Symposium, at text accompanying notes 1-16.

64. This has become a major issue in regard to health planning programs. See note 45 *supra*.

65. For a good summary of the politics and accomplishments of the 95th Congress, see Schneider, *Congressional Action on Health Issues: 1978*, 12 CLEARINGHOUSE REV. 895 (1979).

66. See note 8 *supra*.

67. Extensive hearings were held. See *President's Hospital Cost Containment Proposal: Hearings on H.R. 6575 Before the Subcomm. on Health of the House Comm. on Ways and Means and the Subcomm. on Health and the Environment of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. (1977); *Hospital Cost Containment Act of 1977: Hearings on S. 1391 Before the Subcomm. on Health and Scientific Research of the Senate Comm. on Human Resources*, 95th Cong., 1st Sess. (1977); *Medicare-Medicaid Administrative and Reimbursement Reform Act: Hearings on S. 1470 Before the Subcomm. on Health of the Comm. on Finance*, 95th Cong., 1st Sess. (1977). Several reports were issued. See STAFF OF HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., 2D SESS., SUMMARY OF H.R. 6575 (Comm. Print 1978); STAFF OF HOUSE COMM. ON WAYS AND MEANS, 95TH CONG., 1ST SESS., REPORT ON H.R. 6575 VOLUNTARY HOSPITAL COST CONTAINMENT ACT OF 1978 (Comm. Print 1978); STAFF OF SENATE COMM. ON HUMAN RESOURCES, 95TH CONG., 1ST SESS., REPORT ON HOSPITAL COST CONTAINMENT ACT OF 1977 (Comm. Print 1977); STAFF OF HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., 2D SESS., REPORT ON VOLUNTARY HOSPITAL COST CONTAINMENT ACT OF 1978 (Comm. Print 1978).

For various versions of the Hospital Cost Containment Act of 1977, see S. 1391, 95th Cong., 1st Sess., 123 CONG. REC. S6403 (daily ed. Apr. 26, 1977); H.R. 8121, 95th Cong., 1st Sess., 123

containment became law. Although Senators Gaylord Nelson and Edward Kennedy were able to muster enough votes to pass a very limited version of hospital cost containment in the last days of the session in the Senate,⁶⁸ the House tacitly accepted the hospital industry's offer to control hospital inflation voluntarily.⁶⁹

The controversy over the federal role in controlling the cost of health care was hardly settled in the Ninety-Fifth Congress, and the overall direction of federal policy for the next decade remains to be decided. The Carter Administration will again introduce hospital cost containment and, presumably, will make other regulatory proposals to the Ninety-Sixth Congress; at the same time, the Administration will continue with renewed vigor to implement its existing regulatory authority. One can expect a major confrontation as a coalition of powerful opponents, including provider associations and political conservatives, attempt to defeat the President's regulatory strategy.

While the controversy may remain unresolved well into the next decade, the unrelenting pace of inflation makes it unlikely that Congress can avoid adopting some type of national strategy. Although reluctant to enact regulatory controls, future administrations or Congress simply may opt to limit federal spending, but only a major program limitation would have a significant impact. Yet, any program limitation severe enough to have a visible impact on federal spending would have a serious, even life threatening, impact on the increasing number of people who cannot afford health services without governmental assistance. Politically, we may not be ready for nationalized health insurance, but there is no indication that a major reduction in government spending for health would be a politically acceptable policy either. Other cost containing strategies have been proposed: the indus-

CONG. REC. H6791 (daily ed. June 30, 1977); H.R. 8337, 95th Cong., 1st Sess., 123 CONG. REC. H7171 (daily ed. July 14, 1977).

68. H.R. 5285, 95th Cong., 2d Sess., 124 CONG. REC. S18368, S18408 (daily ed. Oct. 12, 1978). Senator Talmadge's limited version of hospital cost containment, S. 1470, 95th Cong., 1st Sess., 123 CONG. REC. S7106 (daily ed. May 5, 1977) as amended, H.R. 5285, 95th Cong., 2d Sess., 124 CONG. REC. S18328-S18338 (daily ed. Oct. 12, 1978), was attached to the Tariff Schedules of the United States in an attempt to pass a bill in the last few days before the 95th Congress adjourned. At the outset, Senator Kennedy attempted to substitute his version of HCC for the limited approach to HCC. Amendment 2064, 95th Cong., 2d Sess., 124 CONG. REC. S18353-S18358 (daily ed. Oct. 12, 1978). Senator Kennedy's substitute amendment was tabled by a 69-18 vote, indicating very little support for a comprehensive HCC program. *Id.* at S18362. Senator Gaylord Nelson then offered a weaker compromise version of HCC as a substitute for the Talmadge approach. *Id.* at S18368-S18371. This version was further amended by Senators Muskie and Dole, *id.* at S18380, S18304, and then accepted, *id.* at S18394. The bill was passed by the Senate and sent to the House. *Id.* at S18408.

69. See note 41 *supra*.

try has claimed that through voluntary efforts at least the hospital portion of health care costs can be contained,⁷⁰ and free market theorists have claimed that competition free from existing market restraints could control costs more effectively than public control and that, by comparison, existing regulatory programs have given little evidence that any regulatory strategy can be comparably effective.⁷¹

Perhaps Congress will embrace these alternative strategies and reject the regulatory strategy proposed by the current Administration, but such a departure, at least for the moment, seems unlikely. Rather than abandon the regulatory strategy, Congress, as well as the Carter Administration, seems committed to testing its effectiveness and propriety. Whether that commitment will lead to an expansion of federal authority beyond existing programs is difficult to predict; at the least, significant increases in federal authority, such as a program of hospital cost containment, will be given serious consideration by Congress and actively sought by the Carter Administration. At the same time, the Administration will seek to increase the effectiveness of existing regulatory programs. Thus, the limits of federal authority over health care delivery will be debated, examined, and, quite likely, tested.

II. THE PARAMETERS OF FEDERAL AUTHORITY

Any attempt to have a significant impact on the cost of health care, even if ultimately unsuccessful, will represent a substantial expansion of federal authority. Indeed, the intent of the Carter administration to inject a "get tough" element into the federal regulatory posture, whether under existing statutory authority or through new legislation, presupposes the emergence of a new federal role, not only in the relationship between the federal government and health care providers, but also in the relationship between the federal government and state and local governments.

Pending legislative proposals to expand federal authority have therefore generated substantial controversy, highlighting the as yet unresolved political attitude in Congress towards such fundamental issues as the role of the private sector in determining the cost and distribution of health care services and the role of state and local governments as regulators and as providers of services. So far these issues have been debated in Congress in largely political terms, but if cost containing

70. *See id.*

71. *See Wing & Craige*, this Symposium, at note 15.

legislation is enacted, or if new programs are developed under existing authority, the locus of the debate will probably shift to the courts, and these issues will be examined in constitutional terms.

A. *The Spending Authority*

The basic constitutional principle that circumscribes the federal spending authority is easily summarized: Article I, Section 8 of the United States Constitution grants to Congress the power to "lay and collect taxes . . . and provide for the general welfare."⁷² Modern courts have consistently taken an expansive view of this authority and applied a broad interpretation to both the concept of "general welfare" and the discretion vested in Congress to define it specifically.⁷³ Earlier in our history, federally authorized, health-related spending may have

72. U.S. CONST. art. I, § 8, cl. 1.

73. Prior to the 1930s, some authorities argued that the power to tax and to spend was limited to only those matters upon which Congress was explicitly authorized to legislate, the so-called enumerated powers. That position has been refuted, however. Justice Roberts in *United States v. Butler*, 297 U.S. 1 (1935), wrote that the general welfare clause

confers a power separate and distinct from those later enumerated, is not restricted in meaning by the grant of them, and Congress subsequently has a substantive power to tax and to appropriate, limited only by the requirement that it shall be exercised to provide for the general welfare of the United States.

Id. at 65-66. (The *Butler* court held, however, that the Agricultural Adjustment Act of 1935, Pub. L. No. 73-10, ch. 25, 48 Stat. 31, was an unconstitutional invasion of rights traditionally reserved to the states. See discussion of state sovereignty, *infra.*) See Note, 34 WASH. & LEE L. REV. 1133, 1134 n.7, 1141-42 nn.52 & 53 (1977); Comment, *The Federal Conditional Spending Power: A Search For Limits*, 70 NW. L. REV. 293, 297-98 (1975).

The *Butler* concept of the general welfare clause was expanded two years later. In *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937), the Court upheld the constitutionality of a portion of the Social Security Act of 1935 that required employers to pay into state unemployment programs: "It is too late today for the argument to be heard with tolerance that in a crisis as extreme as this the use of the moneys of the nation to relieve the unemployed and their dependents is a use for any purpose narrower than the promotion of the general welfare." *Id.* at 586-87. And in *Helvering v. Davis*, 301 U.S. 619 (1937), decided the same day as *Steward Machine Co.*, the Court upheld the constitutionality of the provision of the Social Security Act that taxed employers and employees for the purpose of creating a retirement benefits program. In both cases, federal authority to tax and to spend for the general welfare was held to include authority over matters that had previously been perceived as local in nature, despite the apparent concern for state sovereignty voiced in *Butler*. Justice Cardozo in *Davis* said:

The line must still be drawn between one welfare and another, between particular and general. Where this shall be placed cannot be known through a formula in advance of the event. There is a middle ground or certainly a penumbra in which discretion is at large. The discretion, however, is not confided to the courts. The discretion belongs to Congress unless the choice is clearly wrong, a display of arbitrary power, not an exercise of judgment. Nor is the concept of the general welfare static. Needs that were narrow or parochial a century ago may be interwoven in our day with the well-being of the Nation. What is critical or urgent changes with the times.

301 U.S. at 640-41.

been subject to constitutional challenge,⁷⁴ but the modern view of the spending authority, coupled with the well-documented national significance of health care services and costs, has erased any doubts concerning Congress' authority to spend federal revenues for virtually anything related to health care.⁷⁵

Furthermore, the judicial interpretation of the conditions that can

74. See, e.g., *Massachusetts v. Mellon*, 262 U.S. 447 (1922). See also *Helvering v. Davis*, 301 U.S. 619 (1937); *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937).

Health was traditionally considered a matter exclusively within the province of the individual states. In *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824), Justice Marshall declared, albeit in dictum, that while the federal government had the power to regulate interstate commerce, "health laws of every description . . . are component parts . . . of that immense mass of legislation, which embraces everything within the territory of a State, not surrendered to the general government: all which can be most advantageously exercised by the States themselves." *Id.* at 203.

In the early days of the Republic, however, the federal government was concerned with other national problems, and issues related to health were rarely raised. In 1796, after a yellow fever epidemic had forced the government to flee from Philadelphia, a national quarantine bill was debated in Congress. This debate brought to the fore the Federalist and Antifederalist positions, with the Antifederalists eventually winning: the quarantine bill was defeated. See Chapman & Talmadge, *Historical and Political Background of Federal Health Care Legislation*, 35 LAW & CONTEMP. PROB. 334 (1970).

After a yellow fever epidemic had swept up the Mississippi River Valley in 1878, however, Congress passed a national quarantine law. Though this bill was more hotly debated in Congress than its forerunner in 1796, and though the law was allowed to expire in 1882, the handwriting on the wall was clear. When a cholera epidemic threatened the eastern seaboard in the early 1890's, Congress passed a national quarantine law that, although amended several times, still stands today. See *id.* at 337-40. Aside from the original federal food and drug laws enacted at the turn of the century, Act of June 30, 1906, ch. 3915, and the maternal and child health services program enacted in 1921, Act of Nov. 23, 1921, ch. 135, however, the federal role in the nation's health remained as limited as Justice Marshall's opinion had dictated until the 1940s. Chapman & Talmadge, *supra*, at 342-43. With the enactment of the Hill-Burton program in 1946, a new federal role in health care began to emerge. See Wing & Craige, this Symposium, at text accompanying notes 159-66 *supra*.

75. See text accompanying notes 113-56 *infra*.

For a legislative statement of the national importance of health care, see § 2 of the National Health Planning and Resources Development Act of 1974:

- (1) The achievement of equal access to quality health care at a reasonable cost is a priority of the Federal Government.
- (2) The massive infusion of Federal funds into the existing health care system has contributed to inflationary increases in the cost of health care and failed to produce an adequate supply or distribution of health resources, and consequently has not made possible equal access for everyone to such resources.
- (3) The many and increasing responses to these problems by the public sector (Federal, State, and local) and the private sector have not resulted in a comprehensive, rational approach to the present—
 - (A) lack of uniformly effective methods of delivering health care;
 - (B) maldistribution of health care facilities and manpower; and
 - (C) increasing cost of health care.
- (4) Increases in the cost of health care, particularly of hospital stays, have been uncontrollable and inflationary, and there are presently inadequate incentives for the use of appropriate alternative levels of health care, and for the substitution of ambulatory and intermediate care for inpatient hospital care.

42 U.S.C. § 300k(a) (1974). See also S. REP. NO. 1285, 93d Cong., 2d Sess. 4-5, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 7842, 7845-46.

be constitutionally imposed on recipients of federal funds, and the discretion vested in Congress to impose those conditions have been equally generous. In fact, the courts have rarely invalidated a spending condition imposed by the federal government on either a private or a public recipient.⁷⁶ Heavy reliance has been placed on the rationale that (a) recipients always remain free to forego federal funds and thus avoid unwanted conditions⁷⁷ and (b) Congress should have broad authority to control the way in which federally funded activities are administered.⁷⁸

Conditional spending authority, however, can be exercised even when these arguments are not clearly applicable. Particularly in an age when reliance on federal spending is both commonplace and essential to many private and public institutions, the decision to refuse federal funds is not always an available option, at least in any practical sense. Moreover, imposing conditions on the recipient of federal funds has become more than a means for controlling expenditures under a particular program. Rather, such conditions frequently are enacted by Congress in order to achieve particular policy choices, using the receipt of federal funds under one or more programs, which arguably might be unrelated to the policy, as leverage to achieve that policy.⁷⁹

Thus, in reviewing the constitutionality of conditions imposed on health care providers who are recipients of federal funds, it is clear that Congress has extremely broad discretion. The scope and nature of congressional authority, however, may be challenged, at least when the condition imposed strains the logic of the traditional constitutional justifications for the conditional spending authority.

For a similar judicial pronouncement, see *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532, 534-35 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

76. See, e.g., *Ivanhoe Irrigation Dist. v. McCracken*, 357 U.S. 275, 295 (1958) ("Also beyond challenge is the power of the Federal Government to impose reasonable conditions on the use of federal funds . . ."); *Oklahoma v. United States Civil Serv. Comm'n*, 330 U.S. 127 (1947); *Massachusetts v. Mellon*, 262 U.S. 447 (1922). See generally Comment, *supra* note 73, at 303-07.

77. In *Massachusetts v. Mellon*, 262 U.S. 447 (1922), the Supreme Court upheld the constitutionality of the federal maternal and child health program, which conditioned disbursement of federal funds to states upon compliance with federal conditions: "the powers of the State are not invaded, since the statute imposes no obligation but simply extends an option which the State is free to accept or reject." *Id.* at 480.

78. See, e.g., *Helvering v. Davis*, 301 U.S. 619 (1937); *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937); *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

79. See note 108 *infra*.

1. The Issue of Voluntary Participation

In examining the constitutionality of conditional spending by the federal government, the courts have frequently distinguished between spending that encourages or induces compliance with a condition and spending that coerces compliance by the recipient of federal funds.⁸⁰ In a recent case involving the State of North Carolina,⁸¹ for example, a federal district court upheld the constitutionality of federal health legislation that required states to enact certificate of need laws as a condition on the receipt of federal funds for health planning and for a variety of other public health programs.⁸² The court considered, but dismissed, North Carolina's argument that the legislation was an improper exercise of the spending authority, holding that the estimated loss of \$50 million in federal funds was not sufficiently "catastrophic" or "coercive" to be "coercion in any constitutional sense."⁸³

While the distinction between conditions that are mandatory or coercive and those that are voluntary and provide only inducements to compliance has been made repeatedly, courts have rarely invalidated an exercise of conditional spending because of its coercive effect,⁸⁴ and have given little indication of the real meaning of this apparent limitation.⁸⁵ Moreover, the argument that coercive conditions would be improper is most persuasively and most frequently stated in reference to

80. *Massachusetts v. Mellon*, 262 U.S. 447, 480 (1922). The majority in *United States v. Butler*, 297 U.S. 1 (1935), while acknowledging that the taxing and spending authority of Congress is a power separate and distinct from the enumerated powers, *see* discussion note 73 *supra*, held that the condition attached to the Agricultural Adjustment Act was a "scheme for purchasing with federal funds submission to federal regulation . . ." *Id.* at 72. In later cases, courts did not ignore the coercion issue raised in *Butler*; they simply held that the spending conditions in question were not coercive. *See Oklahoma v. United States Civil Serv. Comm'n*, 330 U.S. 127 (1947); *Helvering v. Davis*, 301 U.S. 619 (1937); *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937); Comment, *supra* note 73, at 302-03; Note, *supra* note 73, at 1141-44.

81. *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

82. The court stated:

The validity of the power of the federal government under the Constitution to impose a condition on federal grants made under a proper Constitutional power does not exist at the mercy of the State Constitutions or decisions of State Courts. Moreover, the "coercive" effect of a termination of federal assistance on the plaintiff North Carolina seems quite unreal. The actual loss to North Carolina should it lose all federal assistance health grants would be less than fifty million dollars; in 1974, its State revenues totalled some 3.1 billion dollars. The impact of such loss could hardly be described as "catastrophic" or "coercive."

Id. at 535. *See also* note 77 *supra*.

83. *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532, 535 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

84. *But see* *United States v. Butler*, 297 U.S. 1 (1935), and text accompanying note 91 *infra*.

85. *See* *Massachusetts v. Mellon*, 262 U.S. 447, 480 (1922); Comment, *supra* note 73, at 302; Note, *supra* note 73, at 1134.

spending conditions imposed on state and local governments, an argument raising the related but distinct issues of federalism and state sovereignty.⁸⁶

If the coercive effect of conditional federal spending is a relevant constitutional consideration, then significant questions can be raised concerning existing and proposed federal regulatory conditions imposed on health care providers. With respect to the modern health care delivery system, the threat of denial or withdrawal of federal funds may be so large that the provider-recipient is denied any effective choice regarding its participation. Obviously, a health care provider under any comprehensive national health insurance program would be in this position. More to the point, almost every hospital⁸⁷ and many nursing homes⁸⁸ currently depend so heavily on federal financial support, principally through Medicare and Medicaid reimbursements, that there is little choice but to comply with any condition or regulatory requirement imposed by the federal government. Medicare and Medicaid providers have reluctantly accepted numerous conditions imposed on their participation.

Similarly, an undeniably coercive effect can be achieved by imposing a condition on health care providers that involves not just Medicare and Medicaid or any specific program, but rather ties the condition, usually through independent legislation, to the receipt of federal funds from any program or source.⁸⁹ Even providers who can risk nonpar-

86. See text accompanying notes 113-56 *infra*.

87. See Wing & Craig, this Symposium, at text accompanying notes 80-81 *supra*.

88. See *id.* at text accompanying notes 120-22 *infra*.

89. See, e.g., Title VI of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000d to d-6 (1971) (Title VI); Family Education Rights and Privacy Act of 1974, 20 U.S.C. § 1232(g) (1975) (FERPA); Vocational Rehabilitation Act of 1973, 29 U.S.C. §§ 701-94 (1973).

Title VI provides in part: "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal assistance." 42 U.S.C. § 2000d (1971). It goes on to state that compliance will be exacted by "termination of or refusal to grant or to continue assistance under such program or activity to any recipient as to whom there has been an express finding . . . of a failure to comply with such requirement . . ." *Id.* § 2000d-1. Title VI provides further that any such termination or refusal of funds "shall be limited in its effect to the particular program, or part thereof, in which such noncompliance has been so found . . ." *Id.* Thus, a government agency is prohibited by the language of Title VI from withholding funds from programs that do not specifically violate Title VI. This was underscored in *Board of Pub. Instruction v. Finch*, 414 F.2d 1068 (5th Cir. 1968), in which the court vacated an order by HEW cutting off funds to a Florida school district because there was no evidence that any of the three affected federally funded programs in the district was in violation of Title VI.

In FERPA, however, there is no language limiting the cut-off of funds to those recipients who violate the law. FERPA gives parents the right to inspect and review their children's school records and to consent before such records can be released to other organizations. 20 U.S.C. § 1232g(a)(1), (b)(1) (1975). In case of noncompliance by a school, Congress provided that federal

ticipation in Medicaid or Medicare may not be able to risk nonparticipation in all federal programs.

Despite the fact that health facilities have little choice but to comply with federally imposed conditions, no court thus far has been persuaded to invalidate, on this ground, any condition or regulatory program imposed on Medicare or Medicaid providers.⁹⁰ Apparently so long as participation by a provider is literally voluntary (Medicaid and Medicare providers are not legally required to participate) the coercive economic effect, at least for private providers, will not affect the constitutionality of federal regulation through conditional spending.⁹¹ Perhaps under a comprehensive national health insurance scheme, whether explicitly requiring provider participation or giving providers no feasible alternative, the sheer magnitude of the economic coercion may convince the courts that coercion in economic effect is equivalent to coercion in law, and thus, that a different result should be reached. But even if courts were to engage in a factual analysis of the economic circumstances facing participating providers, they are likely to maintain a rather circumscribed view of coercion.⁹²

funds would be cut off to the dilatory recipients. A broad reading of FERPA would permit the government to cut off funds for educational activities that are unrelated to the programs to which FERPA is attached. There are no interpretative cases. See generally Comment, *supra* note 73, at 310-30.

90. In *Rasulis v. Weinberger*, 502 F.2d 1006 (7th Cir. 1974), the court rejected a constitutional challenge to a regulation establishing professional standards for physical therapists participating in Medicaid and Medicare, relying heavily on the finding that the regulation "merely provides standards for the dispensation of Federal funds. The economic incentives of participation in the Medicare Program does not constitute coercion or control." *Id.* at 1010 (citing *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937)).

The court in *Association of Am. Physicians & Surgeons v. Weinberger*, 395 F. Supp. 125 (N.D. Ill. 1975), held that utilization review requirements imposed by the PSRO program, see note 30 *supra*, were not mandatory, that participation of providers in Medicaid and Medicare was voluntary and that therefore the requirement was a valid exercise of the spending authority. *Id.* at 134.

In *Briarcliff Haven, Inc. v. Department of Human Resources*, 403 F. Supp. 1355 (N.D. Ga. 1975), the court held that providers do not have to participate in Medicaid and Medicare, but that if they do, they must comply with both state and federal law. See also *Alabama Nursing Home Ass'n v. Califano*, 433 F. Supp. 1325 (M.D. Ala. 1977); *Coe v. Hooker*, 406 F. Supp. 1072 (D.N.H. 1976); *Shaak v. Schmidt*, 344 F. Supp. 99 (E.D. Wis. 1971); *Opelika Nursing Home, Inc. v. Richardson*, 323 F. Supp. 1206 (M.D. Ala. 1971), *rev'd on other grounds*, 448 F.2d 658 (5th Cir. 1971); *Gould v. Klein*, 150 N.J. Super. 516, 376 A.2d 196 (1976). None of these cases recognizes that institutional providers have little actual choice but to participate.

91. But see text accompanying notes 113-49 *infra*.

92. But see note 101 *infra*.

2. The Relationship Between The Condition and The Funding Program

Congressional authority to impose policy conditions or cost regulation on health care providers in return for federal funds can also be questioned when the condition is not simply a matter of Congress' concern for the manner in which federal funds are spent,⁹³ but is, in effect, an attempt to achieve other objectives.

Although there is little judicial precedent for the proposition, recent legal commentary has argued that a proper reading of the spending authority and the due process clause of the fifth amendment would require that a condition imposed on federal spending be reasonably related to the purpose of the funding program to which it is attached.⁹⁴ To state the issue in more specific terms, aside from whether the condition promotes the general welfare or is, as it must be,⁹⁵ a proper governmental objective in its own right, it can be argued that any condition must relate to the particular general welfare objective of the funding program to which it is attached, or at least to some significant national policy that, presumably, is important enough that all funding programs should adhere to it.⁹⁶

Most existing, and several proposed, federal attempts to impose cost controls on health care providers apply only to the services funded by the program to which they are attached. For example, only services funded by government programs are subject to the PSRO and utilization review requirements of Medicaid and Medicare.⁹⁷ In addition, the sanction imposed on providers for unnecessary capital expenditures under the section 1122 federal certificate of need program is a reduction in federal reimbursement; there is no prohibition on unnecessary capital expenditures.⁹⁸ Yet another example is suggested by the limited hospital cost containment plan considered in the last session of Congress.⁹⁹ Like existing Medicare and Medicaid conditions on participa-

93. See text accompanying note 78 *supra*.

94. See Comment, *supra* note 73, at 305 (suggesting that this limitation is grounded in the fifth amendment).

Justice Stone, dissenting in *United States v. Butler*, 297 U.S. 1, 85-86 (1935), also argued that the conditions must be related to the spending program, but the Supreme Court has never explicitly adopted this position. See also *Ivanhoe Irrigation Dist. v. McCracken*, 357 U.S. 275 (1958).

95. See text accompanying notes 73-75 *supra*.

96. Comment, *supra* note 73, at 308. For examples of significant national policies, see *id.* at 309.

97. 42 U.S.C. § 1320a-1 (1972).

98. Schonbrun, this Symposium, at text accompanying notes 127-49.

99. See text accompanying notes 8-12 *supra*.

tion, this plan would only limit revenues collected by providers under federal programs and would not impose any conditions relating to services funded by nonfederal sources. Thus limited, regulatory efforts fit neatly into the traditional justification for conditional federal spending, and there is an obvious relationship between the spending program and the condition.¹⁰⁰ In each case the condition is intended to provide a limitation on federal expenditures incurred by the program and thus would undoubtedly be within constitutional limits. Indeed, indications are that such conditions will be upheld with a minimum of judicial scrutiny of the condition or the relationship of the condition to the program's objectives.¹⁰¹

100. Commentators have suggested, however, that Congress has intentionally restricted the scope of federal legislation in light of the constitutional implications of expanding the conditional spending power. See, e.g., Comment, *supra* note 73, at 294.

101. In the face of increasing federal efforts to impose cost controls under the Medicaid and Medicare programs, participating providers have attempted to argue that reimbursement for Medicaid and Medicare services involves a fundamental right or interest, either a right to privacy inherent in the patient-provider relationship or a right of providers to practice their profession. *Rasulis v. Weinberger*, 502 F.2d 1006 (7th Cir. 1974); *AMA v. Weinberger*, 395 F. Supp. 515 (N.D. Ill.), *aff'd*, 522 F.2d 921 (7th Cir. 1975); *Association of Am. Physicians & Surgeons v. Weinberger*, 395 F. Supp. 125 (N.D. Ill. 1975).

Providers have contended that both the objective sought to be achieved by conditions imposed on Medicaid and Medicare participation and the means sought to achieve the objective should receive close judicial scrutiny, citing the close scrutiny given to the means used to accomplish the objectives of state abortion statutes. See *Doe v. Bolton*, 410 U.S. 179 (1973); *Roe v. Wade*, 410 U.S. 113 (1973). See also *Planned Parenthood v. Danforth*, 428 U.S. 52 (1976). The apparent assumption behind this argument is that under stricter examination the general objective of conditions on Medicaid and Medicare—saving federal program funds—would not be a sufficient rationale to justify interference with the fundamental interest at stake, or that under closer examination conditions such as utilization review requirements could not be shown to have a sufficiently convincing connection with their intended objective. Cf. *Doe v. Bolton*, 410 U.S. 179 (1973), in which the Court concluded that there was no demonstrated relationship between the statutory objective and the requirement of a second opinion.

Generally, courts have declined to adopt this view of the provider's interest in reimbursement, and have treated the provider's interest in much the same manner as the entitlement interest of beneficiaries to social welfare programs; i.e., legislative determinations regarding the dispensation of funds for social welfare programs need only be rational to meet the standards of substantive due process. *Association of Am. Surgeons & Physicians v. Weinberger*, 395 F. Supp. 125, 132 (N.D. Ill. 1975). See *Maier v. Doe*, 432 U.S. 464 (1977); *Dandridge v. Williams*, 397 U.S. 471 (1970). Indeed, the Supreme Court's opinion in *Maier* would seem virtually to preclude this line of argument. In *Maier*, the Court held that a state opting to provide a Medicaid program for the indigent can exclude coverage for "non-therapeutic abortions" without interfering with the fundamental right to privacy recognized in *Roe v. Wade*, 410 U.S. 113 (1973); the *Maier* Court specifically rejected the closer scrutiny of the classifications made by the statutory program and inquired only whether the legislation had a reasonable basis. *Maier v. Doe*, 432 U.S. 464, 474, 479 (1977).

Assuming the Court would hold the federal government to similar standards under a due process analysis, if the beneficiary of the Medicaid program has no fundamental interest in the receipt of services, then any provider interest in reimbursement must have no greater constitutional protection, particularly since the precedential basis for arguing that either beneficiary or provider has a fundamental interest at stake must come from the same line of cases. For a line of cases reflecting this attitude toward provider reimbursement, see the analysis of depreciation recapture in *Springdale Convalescent Center v. Mathews*, 545 F.2d 943 (5th Cir. 1977); *Hazelwood*

A more analytically complex issue arises when federal funding is conditioned on compliance with regulatory controls that affect not only the costs of the services funded by the program but health costs in general. Arguably, that is already the intent of some federal conditions on spending.¹⁰² More importantly, as the pressure mounts to "do something" about the overall cost problem, it seems quite likely that Congress will attempt to control both the costs of services funded by government programs and the costs of services in general, as in the case of the comprehensive cost containment proposal.¹⁰³ Congress may opt to use its conditional spending authority for this purpose.

There should be no constitutional problem if policy conditions or attempted regulation attached to a spending program serve both the broader objective and the objective of the program. For example, the threat of reduced or denied Medicaid and Medicare reimbursement under the federal certificate of need program may successfully discourage health facilities from unnecessary capital expenditures altogether or encourage compliance with health planning guidelines; in either case the costs of health care in general would be affected along with the costs of those federal programs. So long as the attempted objective of the policy condition or regulation imposed is to control the cost, efficiency or quality of the funding program, or to facilitate in any other way the general goals of the program, then the condition would obvi-

Chronic and Convalescent Hosp. v. Weinberger, 543 F.2d 703 (7th Cir. 1976). See also *Daughters of Miriam Center for the Aged v. Mathews*, 590 F.2d 1250 (3d Cir. 1978).

Thus, unless the current judicial attitude towards the constitutional importance of entitlement programs changes, it is unlikely that providers' reimbursement interests will receive anything more than cursory examination. Note, however, that while holding social welfare programs to a lesser standard of scrutiny, these cases could be cited as support for the proposition that the objective of the condition must relate—at least reasonably—to the objective of the program to which they are attached.

One important implication of this lesser standard of review may be that regulatory conditions that rely on "guesstimates," aggregate or partial data, or arbitrary ceilings on costs, are more likely to survive judicial examination.

102. The various regulatory controls imposed by the 1972 amendments to the Social Security Act, Pub. L. No. 92-603, 86 Stat. 1329, are generally directed towards federal expenditures, but the distinction between controlling overall health costs and controlling the costs of Medicaid and Medicare is not complete; for example, § 223 imposes limits on the ability of participating providers to bill beneficiaries for costs excluded by the § 223 program. See 42 U.S.C. § 1395x(v)(1)(B) (1976).

More recent federal legislation obviously seeks to achieve broader purposes. The National Health Planning and Resources Development Act of 1974 is clearly intended to achieve both the broader purpose of controlling costs and the more direct purpose of limiting federal expenditures. see 42 U.S.C. § 300k (1976); the 1974 legislation attempts to interrelate some of the cost control conditions of the Medicaid and Medicare programs with the new health planning program established by the legislation.

103. See text accompanying notes 39-50 *supra*.

ously be constitutional despite the relation of the regulation or policy condition to a broader objective as well.

A more difficult connection between the condition and the program objective arises when a condition is imposed on severable activities and the clear purpose of the condition is to control not only the costs of those activities that are funded with federal dollars, but of those that receive funding from nonfederal sources as well. For example, the utilization review requirements imposed on Medicaid and Medicare participants might be extended to require providers to perform utilization review on all services rendered, not just those funded under the programs.¹⁰⁴ Or to consider the most extreme example, Congress could establish a hospital cost containment program similar to the comprehensive proposal sought by the Carter Administration,¹⁰⁵ requiring hospitals participating in Medicaid and Medicare to accept a limit on revenues collected from all sources or face denial of participation in Medicaid and Medicare. In both cases, the condition would be imposed on activities that are clearly not federally funded, and therefore, with respect to those activities, the condition would serve only the broader objective of controlling general costs.

Even under these circumstances, the condition may be valid. First, to distinguish between the objective of programs such as Medicaid and Medicare and the objective of controlling costs in general may be artificial. If the broadly worded legislative intent of those programs¹⁰⁶ is to be taken seriously, the purpose of funding these programs is to assure financial access to health services and to provide for those Americans who cannot afford health care.¹⁰⁷ The argument can thus be made that

104. See text accompanying notes 25-30 *supra*. Currently the program is limited to review of inpatient services that are funded by federal programs and rendered by institutional providers. For a description and in-depth discussion of this program, see Price, Katz & Provence, *An Advocate's Guide to Utilization Review*, 11 CLEARINGHOUSE REV. 307 (1977).

105. See text accompanying notes 39-50 *supra*.

106. The intent was to

enabl[e] each State, as far as practicable under the conditions in such State, to furnish (1) medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services, and (2) rehabilitation and other services to help such families and individuals attain or retain capability for independence or self-care

42 U.S.C. § 1396 (1976). Since Medicaid's original enactment in 1965, however, significant changes have occurred through judicial and legislative meddling. See Butler, *The Medicaid Program: Current Statutory Requirements and Judicial Interpretations*, 8 CLEARINGHOUSE REV. 7 (1974); Silver & Edelstein, *Medicaid: Title XIX of the Social Security Act - A Review and Analysis*, 4 CLEARINGHOUSE REV. 239 (1970).

107. Medicaid and, more particularly, Medicare have substantial "cost-sharing" provisions. For a description, see Butler, *supra* note 106, at 15-16. See also Butler, *An Advocate's Guide to the Medicare Program*, 8 CLEARINGHOUSE REV. 831, 833-35 (1975). Therefore, beneficiaries of those

the imposition of cost controls that affect the costs charged to consumers not financed under the programs may still be achieving the broader purposes of these programs.¹⁰⁸ As indicated above, courts have generally given rather minimal scrutiny to governmental program objectives and their relationship to program conditions.

Moreover, even truly unrelated conditions attached to federal programs may be constitutional if courts continue to rely heavily on the persistent, if unrealistic, notion that participation in Medicaid and Medicare is voluntary.¹⁰⁹ The courts may well take the position that

programs are directly affected by the costs of providers, and beneficiaries are at the same time both private patients—for those services not covered or those costs not reimbursed—and program beneficiaries. Thus, the government has a strong interest in the costs charged to private patients, and this interest is directly related to the objectives of those federal programs. For example, as one of the conditions of participation by Medicare providers, the Medicare regulations define the circumstances under which beneficiaries can be billed. 42 C.F.R. § 405.601 (1977).

108. Another argument that relates the costs of government funding programs to the costs of health care in general is that controls on all payors may be necessary to prevent the costs of government funded services from being shifted to private patients, thus allowing providers to avoid cost controls on such programs as Medicaid and Medicare by "taxing" non-program patients. Again, the degree of scrutiny by the courts of the relationship between program and condition is as important as the substance of the argument. See note 101 *supra*. Also note that an unrelated condition may be justified because it facilitates a significant national policy (for example, compliance with civil rights laws). See note 89 *supra*. An interesting, if somewhat minor, example of what might be seen as an unrelated condition (which is probably not related to a significant national policy) is the recent concern over the composition of the boards of directors of fiscal intermediaries under Medicare and Medicaid. HEW Secretary Joseph E. Califano recently announced that he would require Blue Cross plans that provide fiscal intermediary services to the Medicare and Medicaid programs to include more consumer representatives on their boards of directors. See WASHINGTON REP. ON HEALTH LEGIS., January 3, 1979, at 3. Opponents of this move undoubtedly will argue that it is difficult to document a factual basis for concluding that provider-dominated boards of directors somehow lead to bad performance of intermediary services. Thus, they will argue, there is no connection between the condition and the purpose of the program in which they are participating. On the other hand, HEW will argue that it is free to contract with anyone for such services and on whatever terms it may choose. Thus postured, the issue does suggest the way courts have looked at conditions imposed on reimbursement of providers, that is, provider participation is comparable to a contract and therefore HEW can attach any condition so long as the provider's participation is voluntary and not coerced. The argument is more persuasive when applied to the true contract, as is the case with fiscal intermediaries, because there are significant differences between the spending of funds pursuant to a contract with a fiscal intermediary and the spending of funds to reimburse participating providers.

109. Obviously, an extension of Medicaid and Medicare or the enactment of nationalized health insurance with mandatory participation by providers would require a different analysis. The issue, however, may be raised under current circumstances. The argument can be made that some providers must participate in Medicaid and Medicare under existing law because of Hill-Burton agreements to do so, see Rose, *Federal Regulation of Services to the Poor Under the Hill-Burton Act: Realities and Pitfalls*, 70 NW. L. REV. 168, 194-200 (1975), or because of the consequences that would result from the loss of their tax exempt status, see Bromberg, *Financing Health Care and the Effect of the Tax Law*, 39 LAW & CONTEMP. PROB. 156 (1975).

Thus, federal law can be seen as "mandating" participation. But in both cases, participation is still, theoretically, voluntary. Providers voluntarily accepted Hill-Burton funds and voluntarily sought tax exempt status. Having done so, their required participation in federal programs is the *quid pro quo* for those voluntary acts.

the government is free to attach any condition to a voluntary spending program, whether related to the program objectives or not, so long as recipients are free to withdraw or decline participation in the program.

Thus, the federal spending authority could be extended to impose any type of regulatory controls on health care providers who rely on government spending, provided the imposition of the regulatory control or policy is in the form of a condition on the receipt of federal funds.¹¹⁰ On the other hand, the logic of this expansive view of federal authority would also indicate that conditions are valid only so long as they are true conditions, that is, so long as the sanction for noncompliance relates only to the continuation of the funding or the reimbursement received. The penalty tax portion of Carter's comprehensive hospital cost containment program may not, therefore, be entirely justified as a proper extension of the conditional spending authority. The penalty tax, which is affixed to revenues collected from private sources above the imposed limit, might be subject to challenge, not because it serves an unrelated objective, but because the enforcement mechanism of the condition is accomplished by means other than the withdrawal or reduction of federal funds or the denial of participation in federal programs. In fact, since the Carter comprehensive plan would apply to all hospitals regardless of whether they participate in Medicaid and Medicare, the portion of the plan limiting collection of revenue from private sources is literally mandatory, not voluntary.¹¹¹ It is best viewed as a separate statutory provision, and independent constitu-

110. Obviously this would not mean that the only sanction available would be termination of future participation. The current structure of the reimbursement process allows periodic payments to providers and retrospective adjustments at the end of each fiscal year. 42 U.S.C. § 1395f (1970). Providers are frequently penalized for failing to adhere to conditions and reimbursement is adjusted accordingly; it is not simply terminated. *Id.*; 42 C.F.R. § 100.103 (1978).

Providers might even be required to return reimbursement from private patients (or not collect it), if the ultimate sanction for not doing so were a comparable adjustment in reimbursement or denial of the provider's participation in the program.

111. Carter's proposal could be limited to only those providers participating in Medicaid and Medicare. Only participating providers would have to comply with revenue limitations on all patients; failure to comply would lead to denial of participation or a reduction of reimbursement. But if the revenue limitation is also enforced by another sanction, for example, the imposition of a civil penalty, presumably enforced with appropriate criminal sanctions, then it is questionable whether this could still be properly regarded as merely conditional spending since the requirement is more than a true condition.

In *Hospital Ass'n v. Toia*, 435 F. Supp. 819 (S.D.N.Y. 1977), the court held that a condition imposed by the Medicaid statute on participating states, which required that the state, under certain conditions, waive immunity to suits by providers seeking reimbursement, was a valid exercise of the congressional spending authority. 42 U.S.C. § 1396(a)(9) (1970) (repealed 1976). The court treated the requirement as a voluntary condition, even though it led to a judicially enforceable obligation. Note, however, that the sanction for noncompliance was related to participation in the program (failure to sign the waiver resulted in a 10% penalty on all Medicaid reimbursements, 42

tional justification would be required.¹¹² A similar program, however, with sanctions relating only to the provider's participation status or reimbursement, may be a constitutionally permissible condition on federal spending.

B. State Sovereignty and The Spending Authority

Even if a federal policy condition or an attempt to impose cost controls on providers that receive federal funds clearly falls within the constitutional principles defining the federal spending authority, the exercise of that authority may nonetheless be considered unconstitutional if it interferes too greatly with the sovereignty of individual state governments.¹¹³ The exact parameters of this notion of federalism are difficult to define.¹¹⁴ In recent years the Supreme Court has shown an increased concern for the protection of state sovereignty and a willingness to assert state sovereignty as an affirmative limitation on federal authority, effectively reviving a constitutional doctrine that had been

U.S.C. § 1396b(L) (1979)) and providers were not directly forced into compliance by the threat of other governmental sanctions.

112. The penalty tax on revenues collected could, however, be independently sustained as a proper exercise of the congressional taxing power under U.S. CONST. art. I, § 8. Although the taxing power has not been used frequently in recent years for regulatory purposes, federal taxes imposed not solely as revenue measures, but with the purpose of regulating the taxed activity, have generally been upheld. *See, e.g.,* United States v. Sanchez, 340 U.S. 42 (1950) (tax on marihuana); *Sonzinsky v. United States*, 300 U.S. 506 (1937) (tax on firearms); *McCray v. United States*, 195 U.S. 27 (1904) (tax on artificially colored oleomargarine). Apparently, if some revenue is raised, the courts are reluctant to examine the other motives of Congress. As the court in *Sonzinsky* stated with reference to a tax on firearms:

[w]e are not free to speculate as to the motives which moved Congress to impose it, or as to the extent to which it may operate to restrict the activities taxed. As it is not attended by an offensive regulation, and since it operates as a tax, it is within the national taxing power.

Sonzinsky v. United States, 300 U.S. 506, 514 (1937).

113. Precedent for this principle can be derived from *United States v. Butler*, 297 U.S. 1 (1935). In *Butler*, the Agricultural Adjustment Act of 1935, Pub. L. No. 73-10, ch. 25, 48 Stat. 31 (1935) (imposing a tax on cotton processors and making payments to farmers who reduce production), was held to be unconstitutional even if properly within the scope of the taxing and spending authority because it invaded an area of legislation reserved to the states. Later cases did not ignore this principle, but held that inducing states to participate in Federal programs with the offer of federal funds was constitutional since it did not "coerce" state participation. *See* note 80 *supra*. Thus, federal spending for the general welfare has been generally accepted as constitutionally permissible even when it involves activities or interests of traditional state concern. The issue that must be addressed, however, is whether, in light of recent renewed interest in state sovereignty, *see* notes 114-16 *infra*, conditional spending can transgress the line from inducement to coercion or violate the increasingly emerging, but largely undefined, principles of federalism.

See also discussion of interstate commerce authority and state sovereignty in text accompanying notes 213-26 *infra*.

114. *See* Michelman, *States' Rights and States' Roles: Permutations of "Sovereignty" in National League of Cities v. Usery*, 86 YALE L.J. 1165 (1977); Comment, *supra* note 73; Note, 76 COLUM. L. REV. 990 (1976); Note, *supra* note 73.

virtually dismissed in prior decisions.¹¹⁵ In *National League of Cities v. Usery*,¹¹⁶ a sharply divided Court declared unconstitutional the extension of the federal fair labor standards law to include employees of state and local government. Writing for the majority, Justice Rehnquist argued:

If Congress may withdraw from the States the authority to make those fundamental employment decisions upon which their systems for performance of these functions must rest, we think there would be little left of the States' "separate and independent existence." . . . Thus, even if appellants may have overestimated the effect which the Act will have upon their current levels and patterns of governmental activity, the dispositive factor is that Congress has attempted to exercise its Commerce Clause authority to prescribe minimum wages and maximum hours to be paid by the States in their capacities as sovereign governments. In so doing, Congress has sought to wield its powers in a fashion that would impair the States' "ability to function effectively in a federal system . . ."¹¹⁷

While the *National League of Cities* Court expressly refrained from applying its analysis to other federal powers,¹¹⁸ the principles of federalism pronounced in that case could logically apply to exercises of the spending authority as well.¹¹⁹ Although this special concern for state sovereignty may be confined to an examination of the tremendous scope of the federal commerce authority, it might also be relevant in an examination of the scope of federal power under the spending authority, which can be quite broad as well.¹²⁰ If *National League of Cities* has signaled an intensified judicial concern for the separate and independent existence of state and local government, it could translate into the recognition that there are affirmative limitations on the federal spending authority, particularly in an age in which state and local governments depend so heavily on federal funding for almost every public

115. See, e.g., *Fry v. United States*, 421 U.S. 542 (1975); *Maryland v. Wirtz*, 392 U.S. 183 (1968); *United States v. Darby*, 312 U.S. 100 (1941). See also *National League of Cities v. Usery*, 426 U.S. 833, 856 (1975) (Brennan, J., dissenting).

116. 426 U.S. 833 (1975).

117. *Id.* at 851 (citations omitted).

118. *Id.* at 852 n.17. Subsequent opinions of the Court have analyzed federal legislation enacted under other sources of federal authority in a much different fashion. Cf. *Fitzpatrick v. Bitzer*, 427 U.S. 445 (1975) (federal legislation under the power conferred by the fourteenth amendment).

119. Note, *supra* note 73, at 1155.

120. There are, however, obvious qualitative differences between federal legislation enacted under the spending authority and legislation enacted under the commerce authority. For instance, commerce legislation is mandatory, and spending authority legislation is, at least theoretically, voluntary. For an interesting perspective on this point, see *Montgomery County v. Califano*, 449 F. Supp. 1230, 1248 (D. Md. 1978).

service they provide, not the least of which are social welfare and health programs.¹²¹

Having recognized the possibility of this affirmative limitation on the spending power, it is difficult even to sketch the specific application of the limitation in this context. So far, the judiciary, including the Supreme Court, has been reluctant to expand the *National League of Cities* analysis to other federal powers,¹²² and the opinion understandably provides little more than general guidance for future applications

121. See Wing & Craig, this Symposium, at note 5.

122. The application of *National League of Cities* has, for the most part, been limited to the commerce power. Courts have repeatedly rejected application of *National League of Cities* to the congressional powers conferred by the fourteenth amendment. See, e.g., Fitzpatrick v. Bitzer, 427 U.S. 445 (1976); Marshall v. City of Sheboygan, 577 F.2d 1 (7th Cir. 1978); United States v. City of Chicago, 573 F.2d 416 (7th Cir. 1978); Arritt v. Grisell, 567 F.2d 1267 (4th Cir. 1977); Love v. Waukesha Joint School Dist. #1, 560 F.2d 285 (7th Cir. 1977); Usery v. Charleston City School Dist., 558 F.2d 1169 (4th Cir. 1977); Usery v. Allegheny County Institution Dist., 544 F.2d 148 (3d Cir. 1976), cert. denied, 430 U.S. 946 (1977).

Lower courts have also held consistently that *National League of Cities* imposes no limitation on congressional power to raise and support armed forces. See, e.g., Camacho v. Public Serv. Comm'n, 450 F. Supp. 231 (D. P.R. 1978); Schaller v. Board of Educ., 449 F. Supp. 30 (N.D. Ohio 1978); Peel v. Florida Dep't of Transp., 443 F. Supp. 451 (N.D. Fla. 1977).

National League of Cities has been construed as not imposing a limitation upon federal anti-racketeering statutes, *In re Grand Jury Proceedings*, 563 F.2d 577 (3d Cir. 1977); as not imposing a tenth amendment limitation upon the SEC's authority to order a preliminary investigation into a city's bond proposal, even though such investigation might force the city into an alternative and possibly more expensive means of raising money, *City of Philadelphia v. SEC*, 434 F. Supp. 281 (E.D. Penn. 1977); and as not prohibiting the preemption of health insurance statutes that conflicted with federal statutes, *Standard Oil Co. v. Agsalud*, 442 F. Supp. 695 (N.D. Cal. 1977).

With respect to the spending authority, *National League of Cities* has uniformly been interpreted not to limit congressional power based on the spending authority. See, e.g., *City of Macon v. Marshall*, 439 F. Supp. 1209 (M.D. Ga. 1977) (conditions imposed upon states for receipt of federal funds under Urban Mass Transportation Act, no violation of tenth amendment); *Stiner v. Califano*, 438 F. Supp. 796 (W.D. Okla. 1977) (Social Security Act regulations may, without violating tenth amendment, require day-care centers receiving federal funds to maintain minimum staffing ratios); *Dupler v. City of Portland*, 421 F. Supp. 1314 (D. Me. 1976) (city violated federal Food Stamp Act by reducing local welfare funds to recipients by amount recipients received in food stamps); *City of Boston v. Hills*, 420 F. Supp. 1291 (D. Mass. 1976) (federal statute granting HUD power to control rents on federally subsidized housing projects, even though in conflict with city rent control ordinance, not violative of tenth amendment). See also cases cited note 141 *infra*.

Nevertheless, there is no doubt that *National League of Cities* stands for a resurrection, however modest, of a concern for state sovereignty. Though it has been limited almost to its facts, it does provide a jumping-off point for more drastic curtailments of federal power. See, e.g., *Davids v. Akers*, 549 F.2d 120 (9th Cir. 1977) (power of Speaker of Arizona House of Representatives to appoint only Republicans to committees is an "essential decision regarding the conduct of integral governmental functions," and thus action challenging that power presents no cognizable federal claim under the first and fourteenth amendments). But see *Elrod v. Burns*, 427 U.S. 347 (1976) (Democratic sheriff violated first amendment by firing his Republican predecessor's employees); *United States v. Best*, 573 F.2d 1095 (9th Cir. 1978) (federal magistrate is without power to suspend California driver's license of person arrested for drunken driving on a federal enclave); *Donohoe Constr. Co. v. Montgomery County Council*, 567 F.2d 603 (4th Cir. 1977), cert. denied, 438 U.S. 905 (1978) (federal courts unwilling to intervene in local condemnation proceedings absent egregious abuse of the condemnation power).

of the federalism principles it recognizes. It is even difficult to characterize the exact nature of the state sovereignty interest being protected.

Rehnquist's opinion can be seen as emphasizing at least two different aspects of state sovereignty: his stated concern for "essential state functions" suggests that the proper inquiry should focus exclusively on the survival of the state as provider of certain services or as performer of specific functions;¹²³ yet his analysis also suggests that he is willing to balance state and federal interests, and that his concern is not for specific state functions, but for the overall impact on the federal system.¹²⁴ As applied to spending programs, this balancing test could call for a renewed examination of the coercive effect of federal funding on state and local government and provide a more flexible approach to the federalism problem.¹²⁵

Whatever specific line of analysis will be employed, undeniably the impact of federal health care cost controls on what could be considered essential or traditional functions of state and local government is already substantial and will likely increase under both existing federal authority and pending hospital cost containment proposals. State, as well as county and municipal, governments are major providers of health care. States traditionally have directly provided care for the mentally ill, developmentally disabled and people with chronic diseases.¹²⁶ Most large cities and many counties maintain hospitals and clinics for the poor,¹²⁷ in addition to providing a variety of related public health services.¹²⁸ Already, the various conditions of participation

123. Justice Rehnquist was clearly concerned with the survival of "States as States," 426 U.S. at 842, and in specifying his concern, he relied heavily on the concept of "functions essential to separate and independent existence," *id.* at 845 (quoting *Coyle v. Oklahoma*, 221 U.S. 559, 580 (1911)). The majority opinion also forbids federal legislation displacing any state function that "may substantially restructure traditional ways in which the local governments have arranged their affairs." *Id.* at 849. See also Justice Brennan's discussion of the essential services and functions concept in his dissent. *Id.* at 864.

124. As has been suggested by the considerable legal commentary generated by this case, Rehnquist's various rhetorical expressions of his concern and his weighing of the impact of the federal legislation indicates that he is in fact employing a balancing test, and that he is not concerned solely with the survival of specific state functions, but with the overall impact of the federal legislation on the sovereign state. See *id.* at 848. See also Michelman, *supra* note 114, at 1167 n.11; Note, *supra* note 73, at 1151. By overruling *Maryland v. Wirtz*, 392 U.S. 183 (1968), but distinguishing *Fry v. United States*, 421 U.S. 542 (1975), the majority opinion effectively balanced the state's interest in sovereignty against a variety of federal policy considerations. 426 U.S. at 852-54.

125. See generally Koran, *Mental Health Services*, in *HEALTH CARE DELIVERY IN THE UNITED STATES* (S. Jonas, ed. 1977).

126. See text accompanying notes 80-92 *supra*.

127. See Wing & Craige, this Symposium, at text accompanying notes 62 & 63.

128. J. HANLON, *PRINCIPLES OF PUBLIC HEALTH ADMINISTRATION* 128-59 (5th ed. 1969).

under the federal Medicaid and Medicare legislation substantially impact on these public providers:¹²⁹ utilization review requirements¹³⁰ and federal certificate of need restrictions on capital expenditures¹³¹ substantially regulate internal administrative decisions as well as expressions of local preferences. If hospital cost containment legislation were enacted, the federal impact on the hospital portion of these local government activities could be quite drastic, unless public providers are exempted from coverage.¹³²

Federal cost control efforts also impact on the state, not as a provider of services, but as a regulator of health care and as an administrator of health programs—functions that may be perceived as “essential.”¹³³ This impact has already led to controversy. There is an increasing tension between states administering their Medicaid programs and HEW, which is attempting to increase federal influence over those programs and to use those programs to achieve federal policies. For example, HEW has tried to use available sanctions, including reimbursement penalties, to require states to impose federal cost control requirements on Medicaid providers.¹³⁴ In some cases, controversies have arisen when states have sought to implement their own cost strategies in administration of their Medicaid programs, but HEW has opposed these attempts as incompatible with federal Medicaid law or policy.¹³⁵

The 1974 federal health planning legislation¹³⁶ effectively extended federal control over not only all state planning and resource development activities, including state certificate of need laws, but also over the internal administration of the state programs and the structure of state agencies.¹³⁷ The federal legislation sets a specific timetable for the enactment of state legislation to conform to the requirements outlined in the federal law.¹³⁸ Hospital cost containment would go even

129. Not all public providers of health care are eligible to participate in federal programs. For example, inpatient psychiatric hospital services are excluded from Medicaid coverage (for beneficiaries over 20 years old). 42 U.S.C. § 1396d(a) (1976 & Supp. I 1977).

130. See note 30 *supra*.

131. See note 29 *supra*.

132. See note 44 *supra*.

133. Many of the functions now performed by states as administrators or regulators are hardly traditional state functions.

134. See notes 141 & 144 *infra*.

135. See *id.*

136. See Wing & Craige, this Symposium, at text accompanying notes 184 & 185.

137. 42 U.S.C. §§ 300m through 300m-2 (1976 & Supp. I 1977).

138. *Id.* § 300m-2(b)(2)(A).

further: it would provide for direct federal regulation of health care costs and might even replace some existing state agencies with a federal regulatory body.¹³⁹

Despite the substantial impact on what could be considered essential elements of state sovereignty, thus far, federal cost control efforts that affect state and local governments by imposing conditions on federal health-related spending programs have been upheld. State and local governments, as providers of health care, have not been singled out for separate treatment by courts reviewing the validity of conditions imposed on providers participating in the Medicaid and Medicare programs.¹⁴⁰ Courts have uniformly held that states must conform to the dictates of federal law in administering their Medicaid programs.¹⁴¹ Although courts have been careful to note that federal law intends the states to have a great deal of autonomy in administering Medicaid, they have nonetheless analyzed conditions imposed on states as administrators of Medicaid in virtually the same manner as conditions imposed on providers. Relying heavily on the assumption that participation by a state in Medicaid is voluntary,¹⁴² courts have upheld a variety of federal conditions imposed on the manner in which states administer the program.¹⁴³

Similarly, state challenges to the conditions imposed by the 1974 federal health planning legislation have not been successful, although the impact of that legislation on state sovereignty has been given more thorough examination.¹⁴⁴ In *North Carolina ex rel. Morrow v.*

139. See note 44 *supra*, for proposals to exempt states that have state hospital cost containment mechanisms.

140. Virtually no explicit consideration of "state sovereignty" has been given to the impact of Medicaid and Medicare conditions on state or local governments that are participating providers.

141. See *White v. Beal*, 555 F.2d 1149 (3d Cir. 1977); *Doe v. Beal*, 523 F.2d 611 (3d Cir.), *rev'd on other grounds*, 432 U.S. 438 (1975); *Dodson v. Parham*, 427 F. Supp. 97 (N.D. Ga. 1977); *Shack v. Schmidt*, 344 F. Supp. 99 (E.D. Wis. 1971). See also *Rosado v. Wyman*, 397 U.S. 397 (1970); *King v. Smith*, 392 U.S. 309 (1968).

142. See text accompanying notes 80-92 *supra*.

Medicaid is frequently characterized as a joint state-federal cooperative effort, and much discretion is given to each state to administer its own program under the dictates of the federal statute. See *White v. Beal*, 555 F.2d 1149 (3d Cir. 1977). Nonetheless, the state must conform to any condition in the federal statute or program executed by the state. See also *Hospital Ass'n v. Toia*, 435 F. Supp. 819 (S.D.N.Y. 1977).

143. Thus, courts have effectively discounted the impact on state sovereignty, continuing the traditional distinction between inducement and coercion and continuing to characterize federal spending programs as inducements.

144. *Montgomery County v. Califano*, 449 F. Supp. 1230 (D. Md. 1978); *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978); *Goodin v. Oklahoma ex rel. Oklahoma Welfare Comm'n*, 436 F. Supp. 583 (W.D. Okla. 1977). See also *Park East Corp. v. Califano*, 435 F. Supp. 46, 50 (S.D.N.Y. 1977), in which the court held

Califano,¹⁴⁵ the federal district court upheld the requirement that states enact certificate of need legislation despite the impact on state sovereignty and rejected North Carolina's argument that such legislation violated state constitutional law.¹⁴⁶

The validity of the power of the federal government under the Constitution to impose a condition on federal grants made under a proper constitutional power does not exist at the mercy of the State Constitutions or decisions of the State courts. Moreover, the "coercive" effect of a termination of federal assistance on the plaintiff seems quite unreal. The actual loss to North Carolina should it lose all federal assistance health grants would be less than fifty million dollars in 1974, its State revenues totalled some 3.1 billion dollars. The impact of such loss could hardly be described as "catastrophic" or "coercive".

It must be remembered that this Act is not compulsory on the State. . . .[I]t does not impose a mandatory requirement to enact legislation; it gives the States an *option* to enact such legislation and, in order to induce that enactment, offers financial assistance. Such legislation conforms to the patterns generally of federal grants to the states and is not "coercive" in the constitutional sense.¹⁴⁷

It is important to note that more recent decisions, prompted by *National League of Cities* and other related decisions,¹⁴⁸ have not only given greater consideration to the concept of federalism, but also have re-opened the coercion issue as applied to federal spending programs, implying that there may be a point—not yet achieved—at which the inducement of federal funding may become so great that state participation is coerced both in practical effect and in the constitutional sense.¹⁴⁹

that the 1974 federal health planning legislation "preempts" the field of health planning and that a state is required to comply with federal procedural requirements even when the state is carrying out substantive powers (for example, facility closure) not included in the federal legislation.

145. 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978).

146. See *In re Certificate of Need for Aston Park Hosp., Inc.*, 282 N.C. 542, 193 S.E.2d 729 (1973). Subsequent to North Carolina *ex rel. Morrow v. Califano*, North Carolina enacted another certificate of need law. Law of June 16, 1978, ch.1182, § 2, 1977 N.C. Sess. Laws 71 (codified at N.C. GEN. STAT. §§ 131-175 to -188 (1978)).

147. 445 F. Supp. at 535-36 (1977). (Note that the analysis of the impact is incorrect. Nonparticipation by a state would result in some loss of funds under a variety of federal health programs, but would not result in the loss of all federal health assistance, and particularly not Medicaid. See 42 U.S.C. §§ 300m to 300m-2 (1976 & Supp. I 1977).

148. For a related case also evidencing increased judicial concern for state sovereignty, see *Maryland v. EPA*, 530 F.2d 215 (4th Cir. 1975), *vacated on other grounds sub nom.*, *EPA v. Brown*, 431 U.S. 99 (1977).

149. For example, in *Montgomery County v. Califano*, 449 F. Supp. 1230 (D. Md. 1978), the court held that federal spending must (1) be for the general welfare and (2) not coerce states into giving up their sovereign status:

[W]hile the withholding of federal funds in some instances may resemble the imposition

If implemented under the federal spending authority, federal cost controls such as hospital cost containment may test the application of this newly revived concern for state sovereignty and federalism. These controls will present the states with federal inducements to participation and compliance with regulatory conditions that are at least tantamount to coercion. Medicaid and other federal health funds make up a considerable portion of state budgets, and many state and local government providers, such as public hospitals and clinics, literally rely on Medicaid and Medicare reimbursement for their survival—far more so than most private providers.¹⁵⁰ If federal cost control conditions are imposed on public providers receiving federal funds or participating in Medicaid and Medicare, state and local governments would have little choice but to comply. Similarly, any health planning or regulatory requirement that conditioned continued Medicaid, Medicare or other federal funds on compliance with the federal requirement by a state's health planning or regulatory programs would also leave the state with little choice. And, of course, a nationalized health insurance scheme would raise the stakes even higher and would, for all practical purposes, require compliance by state and local governments—as providers or as administrators—with any federal health policy or cost control condition.

But whether this coercive impact or the resulting imbalance in federal and state authority over health care will persuade the courts to

of civil or criminal penalties and while economic pressure may threaten such havoc to a state's well-being as to cause the federal legislation to cross the line which divides inducement from coercion, that line is not crossed in this case.

Id. at 1247.

150. For example, the municipal hospitals in New York City reported the following percentages of inpatient revenues from Medicaid and Medicare patients in 1977 and 1978:

	1977	1978
Bronx Municipal	74.6	75
Lincoln	74.9	N/A
North Central Bronx	72.0	76
Coney Island	72.3	71
Cumberland	67.2	72
Green Point	68.7	65
Kings County	73.0	69
Bellvue	73.6	70
Harlem	78.8	80
Metropolitan	78.4	78
Sydenham	72.9	76
Elmhurst	63.9	64
Queens	73.5	72

NEW YORK CITY HEALTH POLICY TASK FORCE, A PLAN FOR IMPROVING THE EFFECTIVENESS OF HOSPITAL SERVICES IN NEW YORK CITY app. A (June 20, 1979).

limit federal attempts to regulate or control health care costs through its spending authority is virtually impossible to predict. Certainly if a federal policy condition or regulatory program is attached as a condition to federal funds that are totally unrelated to the purpose of the condition, then a state can make a persuasive case: not only is the condition coercive, it is also unrelated to the purpose of the conditioned funding; therefore, the traditional constitutional justification for the validity of the conditional spending authority is weakened.¹⁵¹ When such conditions are applied to state or local governments, as opposed to private providers, this exercise of the conditional spending authority has the additional constitutional problem of interfering with notions of federalism and state and local government sovereignty. As noted earlier, courts have been generally unresponsive to constitutional attacks on conditional spending, but when they have expressed concern for issues such as the relationship of a condition to the funding program to which it is attached or the problem of coercion-inducement, the case has involved circumstances in which the state has had to bear the burden of the federal condition, not private recipients of federal funds.¹⁵² Particularly if the regulatory condition is intended to be a major, direct effort to control health care costs—as opposed to the marginal efforts that have characterized federal policy until very recently¹⁵³—the federal exercise of the spending authority simply by virtue of its intended impact may be the sort of exercise of otherwise valid authority that offends those who jealously guard the sovereignty of state and local governments. It is worth noting, however, that recent federal legislative proposals for hospital cost containment programs have provided for statutory exemption of existing state cost containment programs.¹⁵⁴ In fact, during legislative consideration of hospital cost containment proposals in the Ninety-Fifth Congress, there was substantial support for an exemption for public hospitals from the federal requirement.¹⁵⁵ Thus political constraints may, as they traditionally have, provide the safeguards for federalism that constitutional doctrine may not.¹⁵⁶

151. See text accompanying notes 77 & 78 *supra*.

152. See text accompanying notes 80-92 *supra*.

153. See programs described in text accompanying notes 24-41 *supra*.

154. See note 44 *supra*.

155. See notes 44 & 45 *supra*.

156. One commentator has hypothesized that political restraints have limited the potential use of the federal spending authority and thus the validity of that authority if fully extended has never been tested. See Comment, *supra* note 73, at 307. It is not insignificant, for example, that public hospitals were exempted from the proposals for hospital cost control. See note 44 *supra*. Moreover, even during the expansion of federal control over health care in the last two decades, the

It seems clear that unless there are sudden doctrinal changes in the judicial interpretations of the spending authority, Congress has tremendous discretion to expand federal control over the costs of health care, meaning both costs generally and costs of government health care programs in particular. Although an aggressive administrative effort to expand federal control under existing authority may encounter significant political constraints—and its own inability to administer effective programs—it could, nonetheless, greatly increase current authority and still be within constitutional bounds.

Nearly any attempt to control the costs associated with federal health care programs, including cost control conditions imposed on Medicaid and Medicare providers that also have the effect of controlling the costs of health care in general, is within the substantive limitations on the federal conditional spending authority. Attempts to directly regulate the costs of health care providers associated with non-federally funded activities should be valid if imposed as conditions on the receipt of federal funds. Even if judicial interpretation of the spending authority requires that such conditions only be imposed when there is a relationship between the condition and the conditioned funding, this requirement may be satisfied by existing programs and will most certainly be satisfied as federal financial involvement in health care expands in the direction of nationalized health insurance.

Federal cost control efforts that affect state and local governments as providers or administrators of health care programs may be examined for their impact on state sovereignty; at this point in time, however, it is difficult to predict how notions of federalism will be applied to exercises of federal spending in this context.

C. The Interstate Commerce Authority

Congressional authority to regulate the health care industry, including control of health care costs, can also be derived from the interstate commerce authority.¹⁵⁷ Despite Congress' traditional reluctance

trend has been to allow the states to administer regulatory programs established by federal law. It seems highly unlikely that, at this point in time, the federal government could bypass state government and administer federal regulatory programs; at least the option of a state program would have to be made available. On the other hand, the 1974 federal health planning legislation was clearly intended to strengthen federal control over the states' administration of health planning programs, and the direct federal financing of local health planning programs was a notable departure from the traditional method of funneling federal funds through state agencies.

157. The United States Constitution grants Congress the power "to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. 1, § 8, cl. 3.

to invoke the commerce authority with specific reference to health care providers, a variety of federal regulatory programs have been extended to include health care institutions and have been upheld as proper exercises of the congressional commerce authority.¹⁵⁸ Thus Congress has—should it choose to use them—broad regulatory powers in addition to those outlined in the previous section and an established constitutional basis for the control of health care costs.

As with the congressional spending authority, the general principles defining the interstate commerce authority have been applied fairly consistently in recent decades.¹⁵⁹ In an unbroken line of cases since the 1930s, the Supreme Court has viewed the interstate commerce authority as an independent and plenary grant of power giving Congress virtually unlimited discretion¹⁶⁰ over private conduct so long as that conduct can be characterized as either affecting or moving through interstate commerce.¹⁶¹ Even local, intrastate activities have been held

158. See text accompanying notes 167-94 *infra*.

159. The general basis for the modern view of the interstate commerce authority was originally established by Chief Justice Marshall in *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824):

The genius and character of the whole government seem to be, that its action is to be applied to all the external concerns of the nation, and to those internal concerns which affect the States generally; but not to those which are completely within a particular State, which do not affect other States, and with which it is not necessary to interfere, for the purpose of executing some of the general powers of the government. The completely internal commerce of the State, then, may be considered as reserved for the State itself.

Id. at 195. Just as importantly, Marshall had an expansive view of commerce, meaning not merely the interchange of goods, but also commercial intercourse, and the prescription of the rules to be applied to that intercourse. *Id.* at 189-90.

Following Chief Justice Marshall's pronouncements in *Gibbons v. Ogden*, Congress was rather inactive in its use of the commerce authority until the late 1800s. In addition, later judicial interpretations of the federal commerce authority were rather restrictive, particularly in balancing the federal commerce authority and the regulatory authority of the states. At the end of the 19th century, the Supreme Court was drawing sharp distinctions between "interstate commerce" and "localized activities." For example, in *United States v. E.C. Knight and Co.*, 156 U.S. 1 (1895), the Court held that the federal antitrust laws did not apply to a manufacturing combination that was characterized as "local in nature."

Slight expansions of federal authority were later recognized, see *Swift & Co. v. United States*, 196 U.S. 375 (1905), but a fairly narrow view of the interstate commerce authority persisted until the 1930s. See cases cited note 160 *infra*.

160. In *United States v. Darby*, 312 U.S. 100, 114 (1941), the Court held that Congress was free to follow its own notion of public policy, including the achievement of policy objectives related to the public health or safety—matters traditionally reserved to the states. Whether this is literally true or whether there are any limits on permissible congressional purposes is not clear. Later cases suggest that Congress must have an "end permitted by the Constitution" and "a means reasonably related to that end." *National League of Cities v. Usery*, 426 U.S. 833, 840 (1976); *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 262 (1964). But the majority of the cases do not mention even this qualification, and it would appear that the regulation of interstate commerce *per se* is a constitutionally permissible end.

161. In *Wickard v. Filburn*, 317 U.S. 111 (1942), the Court stated:

The commerce power is not confined in its exercise to the regulation of commerce among the states. It extends to those activities intrastate which so affect interstate commerce, or

to be valid subjects for congressional control if they fall into a class of activities that taken in the aggregate have a substantial impact on interstate commerce,¹⁶² or if the control of the intrastate activity is necessary or proper as part of the overall regulatory program.¹⁶³ Congress has been allowed to ensure that interstate commerce conforms to federal policy (for example, fair wages paid in the production of goods that will pass through interstate commerce), and also to impose federal policy on activities within a state that are related to interstate commerce after that commerce has occurred (for example, nondiscrimination requirements imposed on public accommodations).¹⁶⁴ Indeed, once it is established that an activity is within the reach of the commerce authority, Congress has been allowed to impose federal policy or to regulate that activity through any reasonable means to achieve virtually any objective it considers appropriate.¹⁶⁵

The willingness of the Supreme Court to defer to congressional discretion and to find that an activity affects or moves through interstate commerce has led many commentators to suggest—at least prior to the Supreme Court decision in *National League of Cities v. Usery*—that the Court has virtually abandoned all limits on congressional discretion under this authority.¹⁶⁶ Given this expansive interpretation of

the exertion of the power of Congress over it, as to make regulation of them appropriate means to the attainment of a legitimate end, the effective execution of the granted power to regulate interstate commerce. . . . The power of Congress over interstate commerce is plenary and complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed in the Constitution. . . . It follows that no form of state activity can constitutionally thwart the regulatory power granted by the commerce clause to Congress. Hence the reach of the power extends to those intrastate activities which in a substantial way interfere with or obstruct the exercise of a granted power.

Id. at 124 (quoting *United States v. Wrightwood Dairy Co.*, 315 U.S. 110, 119 (1942) (citations omitted)).

162. See *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 194-97 (1974) (contrast between scope of the Sherman Act and scope of the Clayton Act); *United States v. Employing Plasterers Ass'n*, 347 U.S. 186, 189 (1954). See also *Katzenbach v. McClung*, 379 U.S. 294 (1964) (civil rights case); *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241 (1964) (civil rights case).

163. See *United States v. Sullivan*, 332 U.S. 689 (1948); *United States v. Darby*, 312 U.S. 100, 118 (1942).

164. The initial cases in this area generally involved federal policy imposed on goods that had not yet entered the stream of interstate commerce, for example, minimum wage or maximum hour limits on the production of goods *to be shipped* in interstate commerce, or on the goods of intrastate competitors. *E.g.*, *United States v. Wrightwood Dairy Co.*, 315 U.S. 110 (1942); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937). Later cases expanded this notion to include regulation of activities occurring after the goods had entered the stream of interstate commerce or after the transactions constituting the interstate commerce connection had occurred—substantially broadening the effective scope of congressional power.

165. See note 160 *supra* and note 166 *infra*.

166. The most recent formulations of the commerce authority indicate that the Supreme Court is willing to allow Congress to regulate activities or entities with only a minimal connection to

the interstate commerce authority, it is hard to imagine that Congress could not opt to regulate almost any aspect of health care delivery. The Supreme Court has continually affirmed the notion that comparable enterprises can be regulated, and that the method and terms of regulation are firmly vested in the discretion of Congress. Both the courts and Congress may have been reluctant to include health care providers within this sweeping authority in the past, but both have come to apply the interstate commerce authority to a variety of health care providers in recent years with little discussion or resulting controversy.

While the interstate commerce authority has not been used as a basis for enacting any of the programs specifically intended to regulate health care providers, in the last decade hospitals, nursing homes and a variety of other health care providers have been found to be engaged in interstate commerce and therefore subject to various federal regulatory schemes enacted under the commerce authority.

When Congress adopted the Fair Labor Standards Act in 1938,¹⁶⁷ establishing minimum wage and working condition requirements for certain generally defined categories of employers engaged in interstate commerce, it apparently intended that health care providers be exempted.¹⁶⁸ Amendments in the 1960s, however, specifically extended

actual interstate commerce, such as financial transactions with other entities engaged in interstate commerce. See *Daniel v. Paul*, 395 U.S. 298 (1969) (paddleboats and food supplies purchased from out-of-state held sufficient to satisfy commerce clause); *Katzenbach v. McClung*, 379 U.S. 294 (1964) (purchase by a restaurant of \$150,000 in supplies from local supplier engaged in interstate commerce had sufficient effect to come within Congress' commerce power). See also *Perez v. United States*, 402 U.S. 146 (1971). The Court has been particularly liberal in its interpretation of congressional authority when Congress' intent to include an entity or activity within commerce-based regulation is clear; the cases restricting the reach of the commerce authority generally involve situations in which the intent of Congress is not clear, as when private litigants claim that certain activities are within interstate commerce for the purpose of the application of federal anti-trust laws. See text accompanying notes 178-92 *infra*.

167. Fair Labor Standards Act of 1938, Pub. L. No. 718, 52 Stat. 1060.

168. In considering the FLSA in 1938, the Chairwoman of the House Committee on Labor gave her assurances to a colleague that hospitals were not covered by the FLSA because they were not engaged in interstate commerce. 83 CONG. REC. 7299 (1938) (response of Rep. Norton to inquiry by Rep. Dempsey). Similarly, assurances were given in the Senate that the Act did not reach local retail or service businesses. 83 CONG. REC. 9176 (1938) (remarks of Sen. Walsh).

The 1961 amendments to the Act specifically exempted hospitals, nursing homes, and mental institutions. Pub. L. No. 87-30, § 9(a)(2), 75 Stat. 71. Previously, nonprofit health care providers had been exempted from the Act's definition of "enterprise." The 1966 amendments, however, both repealed the exemption and amended the definition of "enterprise" to include nonprofit health care providers. See Pub. L. No. 89-601, §§ 102, 201, 80 Stat. 830.

The FLSA now includes:

An enterprise which has . . . employees handling . . . goods or materials that have been moved in or produced for interstate commerce by any person and which . . .

. . . is engaged in the operation of a hospital, an institution primarily engaged in the

the Act's requirements to health care institutions engaged in interstate commerce, and the courts have consistently upheld the application of the Act to a variety of hospitals,¹⁶⁹ nursing homes¹⁷⁰ and other providers.¹⁷¹

The National Labor Relations Act (NLRA),¹⁷² which imposes collective bargaining requirements on employers engaged in interstate commerce,¹⁷³ has also been applied to health care providers.¹⁷⁴ Although until 1974 the NLRA specifically exempted nonprofit hospitals,¹⁷⁵ the National Labor Relations Board (NLRB) has successfully

care of the sick, the aged, the mentally ill or defective who reside on the premises of such institution . . . (whether or not such hospital [or] institution . . . is public or private or operated for profit or not for profit).

29 U.S.C. § 203(S)(5) (Supp. I 1977).

Thus the Act includes a range of health care providers but still requires a specific finding that the individual provider is engaged in interstate commerce.

Note, however, that the legislative history indicates that doctors' offices may not be within this definition. S. REP. NO. 1487, 89TH CONG., 2D SESS., reprinted in [1966] U.S. CODE CONG. & AD. NEWS 3010. At least one court has held, nonetheless, that clinics may be subject to the Act if they meet the general statutory requirements. *Schultz v. Nalle Clinic*, 444 F.2d 1721 (4th Cir.), cert. denied, 404 U.S. 938 (1971). See also 29 C.F.R. § 779.317 (1979).

The 1961 and 1966 amendments also extended the scope of the FLSA to include some public employers, including state operated schools and hospitals. These amendments were upheld in *Maryland v. Wirtz*, 392 U.S. 183 (1968). After the Act was amended in 1974 to include virtually all public employers, the amendments were held to be an unconstitutional invasion of state sovereignty, *National League of Cities v. Usery*, 426 U.S. 833 (1976), and *Maryland v. Wirtz* was specifically overruled. *Id.* at 855. Both opinions, however, implicitly upheld the extension of congressional authority as a proper exercise of the interstate commerce authority. *Id.* at 841-42.

169. See *Maryland v. Wirtz*, 392 U.S. 183, 195 (1968). See also *Hahn v. Ingram*, 362 F. Supp. 982 (D.C. Del. 1973); *Hodgson v. Brookhaven Gen. Hosp.*, 302 F. Supp. 424 (N.D. Tex. 1969), rev'd on other grounds, 436 F.2d 719 (5th Cir. 1970).

170. See *Hodgson v. Jackson*, 351 F. Supp. 291 (W.D. Va. 1972); *Shultz v. Union Trust Bank*, 297 F. Supp. 1274 (M.D. Fla. 1969).

171. See *Wiendenfeller v. Kidulis*, 380 F. Supp. 445 (E.D. Wis. 1974) (private mental institution).

172. 29 U.S.C. §§ 151-169 (1976).

173. The NLRA's jurisdiction is defined as follows: "The term 'commerce' means trade, traffic, commerce, transportation, or communication among the several States . . ." 29 U.S.C. § 152(6) (1976). "The term 'affecting commerce' means in commerce, or burdening or obstructing commerce or the free flow of commerce, or having led or tending to lead to a labor dispute burdening or obstructing commerce or the free flow of commerce." *Id.* § 152(7).

174. In 1947, prior to the express exemption of nonprofit hospitals, the NLRB's assertion of jurisdiction over a nonprofit hospital was upheld by the federal courts. *Central Dispensary & Emergency Hosp.*, 44 N.L.R.B. 533 (1942), enforced, 145 F.2d 852 (D.C. Cir. 1944), cert. denied, 324 U.S. 847 (1945). The court of appeals held that hospitals were in commerce, within the meaning of interstate commerce, citing *AMA v. United States*, 130 F.2d 233 (D.C. Cir. 1942), aff'd, 317 U.S. 519 (1943) and *Jordan v. Tashiro*, 278 U.S. 123 (1928), and that the hospital in question had sufficient connections to interstate activities to satisfy the jurisdictional requirement. 145 F.2d at 853.

Subsequently, Congress amended the Act to exempt nonprofit hospitals (but not other hospitals or nursing homes). Labor Management Relations Act, Pub. L. No. 101, § 101, 61 Stat. 136 (1947).

175. Act of July 26, 1974, Pub. L. No. 93-360, § 1(a), 88 Stat. 395. The amendments removed

claimed jurisdiction over a wide variety of institutional providers,¹⁷⁶ and now claims jurisdiction over almost all hospitals and nursing homes.¹⁷⁷

the nonprofit hospital exemption of 29 U.S.C. § 152(2), and added, in § 1(b), a new § 152(14): "The term 'health care institution' shall include any hospital, convalescent hospital, health maintenance organization, health clinic, nursing home, extended care facility, or other institution devoted to the care of the sick, infirm, or aged person." 29 U.S.C. § 152(14) (1976).

Parenthetically, the 1974 amendments, in § 1(d) and § 2, provide special procedures for labor arbitration and strikes to prevent disruption of health care delivery. 29 U.S.C. § 158(d)(4), (g), § 183 (1976). For a discussion and explanation, see Vernon, *Labor Relations in the Health Care Field Under the 1974 Amendments to the National Labor Relations Act: An Overview and Analysis*, 70 NW. L. REV. 202 (1975).

176. Throughout the 1960s and 1970s, the NLRB extended its jurisdiction to a variety of providers other than nonprofit hospitals. See, e.g., *Von Solbrig Hosp., Inc. v. NLRB*, 465 F.2d 173 (7th Cir. 1972) (application to proprietary hospital with over \$1 million in revenues).

Until 1968, the NLRB's discretionary assertion of jurisdiction over nursing homes was limited to proprietary nursing homes. In *Council 19, Am. Fed'n of State, County & Mun. Employees v. NLRB*, 296 F. Supp. 1100, 1105 (N.D. Ill. 1968), however, the court found no reason for treating nonprofit and proprietary homes differently, and the NLRB began to assert jurisdiction over all nursing homes with gross revenues in excess of \$100,000. The Ninth Circuit upheld the NLRB's decision to extend its jurisdiction to nonprofit nursing homes in *NLRB v. Evangelical Lutheran Good Samaritan Center*, 477 F.2d 297 (9th Cir. 1973). See also *Glen Manor Home for the Jewish Aged v. NLRB*, 474 F.2d 1145, 1149 (6th Cir.), *cert. denied*, 414 U.S. 826 (1973).

The NLRB has also claimed jurisdiction over visiting nurses associations, clinics and physician group practices. See *District Nursing Ass'n*, 210 N.L.R.B. 476 (1974) (interstate commerce found in the receipt of over \$100,000 in combined reimbursements received from Medicare, welfare programs, Veterans Administration and private insurance); *Visiting Nursing Ass'n*, 187 N.L.R.B. 731 (1971); *Quain & Ramstad Clinic*, 173 N.L.R.B. 1185 (1968) (partnership of physicians with \$3.2 million in gross revenues); *Mayo Clinic*, 168 N.L.R.B. 557 (1967) (respondent-clinic agreed to assertion of jurisdiction; only substantive issues were contested).

The Fifth Circuit approved the assertion of jurisdiction over a large clinic with 200 physicians in *Ochsner Clinic v. NLRB*, 474 F.2d 206 (5th Cir. 1973). The Board has also asserted jurisdiction over a variety of clinics. See, e.g., *Malcolm X Center for Mental Health, Inc.*, 22 N.L.R.B. 944 (1976) (mental health facility); *East Oakland Health Alliance*, 218 N.L.R.B. 1270 (1975) (outpatient clinic); *Pius XII School, Inc.*, 218 N.L.R.B. 711 (1975) (alcohol treatment and rehabilitation center); *Planned Parenthood Ass'n*, 217 N.L.R.B. 1098 (1975) (abortion-family planning clinic); *Biomedical Applications*, 216 N.L.R.B. 631 (1975).

Jurisdiction has also been asserted over the suppliers of clinics and doctors. See, e.g., *Metro-politan Orthopedic Ass'n*, 237 N.L.R.B. 51 (1978) (provider of orthopedic devices and services is a health care facility); *Damon Medical Labs*, 234 N.L.R.B. 55 (1978) (jurisdiction asserted, but not as health care facility); *Atwood Leasing Corp.*, 227 N.L.R.B. 1668 (1977) (dismissed for lack of jurisdiction; insufficient revenues involved); *San Diego Blood Bank*, 219 N.L.R.B. 116 (1975) (jurisdiction asserted, but blood bank held not to be a health care institution).

On certain occasions, the NLRB has chosen not to exercise its jurisdiction over small clinics and private practices, while indicating it could do so in its discretion. See *Choice, Inc.*, 212 N.L.R.B. 50 (1974) (NLRB declined to assert jurisdiction over essentially local abortion clinics); *Cleveland Ave. Medical Center*, 209 N.L.R.B. 537 (1974) (ten osteopaths in group practice; NLRB dismissed, declining to assert jurisdiction); *Alameda Medical Group, Inc.*, 195 N.L.R.B. 312 (1972). The NLRB may attempt to expand its jurisdiction to include sole practitioners. In *Jack L. Williams, D.D.S.*, 219 N.L.R.B. 1045 (1975), jurisdiction was asserted over a dentist who employed four other dentists and a staff of twenty-one and had over \$250,000 in gross revenue; the NLRB rejected the argument that the practice of dentistry was per se local. See also *Dr. George Szele, Anesthesiologist*, 238 N.L.R.B. 197 (1978); Vernon, *supra* note 175, at 203.

177. The NLRB now may claim jurisdiction over all nursing homes or visiting nurse associa-

The involvement of health care providers in interstate commerce also has been established under the application of federal antitrust legislation. As originally enacted, the Sherman Act¹⁷⁸ made no specific reference to health care providers or the practice of medicine.¹⁷⁹ Furthermore, in interpreting the Act in the past, many courts, including the Supreme Court on at least one occasion, were unwilling to conclude that health care providers had a sufficient connection to interstate commerce to invoke federal jurisdiction.¹⁸⁰ In the last ten years, however, a "modern view" of health care providers has developed, and the Supreme Court in its recent antitrust decisions has indicated that it has

tions if their gross annual revenues exceed \$100,000, and over hospitals if their revenues exceed \$250,000. See *East Oakland Health Alliance, Inc.*, 218 N.L.R.B. 1270, 1271 (1975).

178. Act of July 2, 1890, ch. 647, 26 Stat. 209.

The Sherman Act's jurisdiction currently extends to: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States" 15 U.S.C. § 1 (1976). And to: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among . . . the several States" *Id.* § 2.

Thus, the jurisdiction of the Sherman Act is essentially coincident with the scope of congressional authority under the interstate commerce clause. See *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 425 U.S. 738, 743 n.2 (1976); *Rasmussen v. American Dairy Ass'n*, 472 F.2d 517, 521-22 (9th Cir. 1972), *cert. denied*, 412 U.S. 950 (1973); *cf. Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 194 (1974).

179. It is unlikely that institutional providers were specifically considered at the time of the enactment of the Sherman Act; at the turn of the century, hospitals and nursing homes were virtually nonexistent, and even the practice of medicine was still at a primitive state of development. See Wing & Craige, this Symposium, at text accompanying notes 22-28.

180. In *AMA v. United States*, 317 U.S. 519 (1943), the Supreme Court held that the acts of a medical society to restrain the activities of a prepaid hospital insurance plan could be a violation of federal antitrust laws. The court also held that the plan's activities were in commerce within the meaning of the Act and that the society was not otherwise exempted from the restrictions of the law.

In *United States v. Oregon Medical Soc'y*, 343 U.S. 326 (1951), however, the Court held that the activities of competing prepaid group practices had not been shown to have a sufficient connection with interstate commerce:

So far as any evidence brought to our attention discloses, the activities of [prepaid group practices] are wholly intrastate. The Government did show that Oregon Physicians' Service made a number of payments to out-of-state doctors and hospitals, presumably for treatment of policyholders who happened to remove or temporarily to be away from Oregon when need for service arose. These were, however, few, sporadic, and incidental.

Id. at 338-39 (citation omitted).

Citing *Oregon Medical Soc'y*, a number of federal courts subsequently held that a variety of health care providers were not engaged in interstate commerce. In *Spears Free Clinic & Hosp. for Poor Children v. Cleere*, 197 F.2d 125 (10th Cir. 1952), the court held that an alleged conspiracy against a chiropractic hospital by the local medical society involved exclusively local activities and that any effect on interstate commerce was "fortuitous and remote." *Id.* at 128. See also *Elizabeth Hosp., Inc. v. Richardson*, 269 F.2d 167 (8th Cir.), *cert. denied*, 361 U.S. 884 (1959); *Riggall v. Washington County Medical Soc'y*, 249 F.2d 266 (8th Cir. 1957), *cert. denied*, 355 U.S. 954 (1958). A few courts persisted in this view until very recently. See *Wolf v. Jane Phillips Episcopal-Memorial Medical Center*, 513 F.2d 684 (10th Cir. 1975); *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 511 F.2d 678 (4th Cir. 1975) (en banc), *rev'd*, 425 U.S. 738 (1976).

changed its view of federal commerce jurisdiction over health care providers.¹⁸¹

The Court's 1976 decision in *Hospital Building Co. v. Trustees of Rex Hospital*,¹⁸² is demonstrative of that new attitude. In that case a small proprietary hospital claimed that another hospital in its area had conspired with local physicians and the local health planning agencies to prohibit plaintiff's relocation and expansion.¹⁸³ The federal district court dismissed the complaint for failure to allege a sufficient nexus with interstate commerce to invoke jurisdiction of the Sherman Act.¹⁸⁴ The court of appeals affirmed, holding that hospital services were purely local in nature and that neither plaintiff nor defendants were engaged in¹⁸⁵ or had an effect¹⁸⁶ on interstate commerce.

The Supreme Court, in a unanimous opinion, reversed, holding

181. Even prior to *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 511 F.2d 678 (4th Cir. 1975) (en banc), *rev'd*, 425 U.S. 738 (1976), some courts adopted the "modern view" of health care providers. In *Doctors, Inc. v. Blue Cross*, 490 F.2d 48 (3rd Cir. 1973), the court held that a non-profit hospital could claim a Sherman Act conspiracy against Blue Cross and local planning agencies since loss of Blue Cross affiliation would have a substantial impact on the flow of interstate supplies to plaintiff's and other area hospitals. In a similar case involving a proprietary hospital and a Blue Cross plan, the United States Court of Appeals for the Fifth Circuit accepted jurisdiction under the Sherman Act and reversed a lower court decision holding that as a matter of law medical services were local in nature. *See St. Bernard Gen. Hosp., Inc. v. Hospital Serv. Ass'n*, 510 F.2d 1121, 1123-25 (5th Cir. 1975). *See also* note 189 *infra*.

182. 425 U.S. 738 (1976).

183. Among the alleged acts were bad faith tactics in opposition to plaintiff's application for a certificate of need, bringing of frivolous lawsuits, and malicious distribution of false information—all for the purpose of blocking plaintiff's proposed relocation and expansion. *See id.* at 740-41.

The exact factual background is not clear from the opinion, and since the complaint was dismissed there was no development of the facts in the courts below. In that complaint, however, the following scenario was alleged: Two large nonprofit hospitals entered into an agreement to participate in a "Joint Long Range Hospital Planning Committee," which included cooperative arrangements for the expansion of facilities and services in the Raleigh, North Carolina area. Under the then existing certificate of need program (since declared unconstitutional by the North Carolina Supreme Court), defendant hospitals allegedly used their influence over the local health planning agency and before the state certificate of need agency to block plaintiff's planned expansion.

When Mary Elizabeth Hospital (Hospital Building Co.) sought permission to expand and relocate, defendants and their employees opposed the project before the local planning agency and before the state agency. After the application was finally approved by the state agency, defendants filed an action for judicial review of the agency decision. (This decision was pending at the time that the antitrust suit was filed.) Plaintiff also alleged that defendants had circulated false information about plaintiff privately and publicly in an effort to impede plaintiff's business. Complaint for Damages and Equitable Relief, *Hospital Building Co. v. Trustees of Rex Hosp.*, 511 F.2d 678 (4th Cir. 1975) (en banc).

184. *See* 511 F.2d 678, 680 (4th Cir. 1975) (en banc), *rev'd*, 425 U.S. 738 (1976).

185. *Id.* at 682. The majority relied heavily on *United States v. Oregon Medical Soc'y*, 343 U.S. 326 (1952); *Elizabeth Hosp., Inc. v. Richardson*, 269 F.2d 167 (8th Cir. 1959); *Spears Free Clinic & Hosp. for Poor Children v. Cleere*, 197 F.2d 125 (10th Cir. 1952).

186. 511 F.2d 678, 685 (1975). *But see id.* at 687 (Winter, J., dissenting).

that plaintiff's purchase of medicine and supplies from out-of-state sources, reimbursement from out-of-state insurance companies and the federal government, management fees paid to plaintiff's out-of-state parent corporation and out-of-state financing for the proposed expansion presented allegations that were certainly sufficient to establish a substantial effect on interstate commerce.¹⁸⁷ In effect, the Court accepted a characterization of health care providers that more accurately reflects the actual nature of the modern American health care delivery system than the anachronistic "local in nature" characterization.¹⁸⁸ The case was remanded to allow plaintiff to proceed on its allegations.

The impact of the application of the Sherman Act and other anti-trust laws to health care providers will depend on the resolution of a number of unsettled issues; cases such as *Hospital Building Co.* may herald the beginning of an era of antitrust litigation against providers, their associations and related institutions.¹⁸⁹ The interstate commerce

187. The Court summarized the allegations as follows:

According to the amended complaint, petitioner purchases a substantial portion—up to 80%—of its medicines and supplies from out-of-state sellers. In 1972, it spent \$112,000 on these items. A substantial number of the patients at Mary Elizabeth Hospital, it is alleged, come from out of State. Moreover, petitioner claims that a large proportion of its revenue comes from insurance companies outside of North Carolina or from the Federal Government through the Medicaid and Medicare programs. Petitioner also pays a management service fee based on its gross receipts to its parent company, a Delaware corporation based in Georgia. Finally, petitioner has developed plans to finance a large part of the planned \$4 million expansion through out-of-state lenders. All these involvements with interstate commerce, the amended complaint claims, have been and are continuing to be adversely affected by respondents' anticompetitive conduct.

425 U.S. at 740-41. The Court then went on to hold:

The complaint, fairly read, alleges that if respondents and their co-conspirators were to succeed in blocking petitioner's planned expansion, petitioner's purchases of out-of-state medicines and supplies as well as its revenues from out-of-state insurance companies would be thousands and perhaps hundreds of thousands of dollars less than they would otherwise be. Similarly, the management fees that petitioner pays to its out of state parent corporation would be less if the expansion were blocked. Moreover, the multimillion-dollar financing for the expansion, a large portion of which would be from out of State, would simply not take place if the respondents succeeded in their alleged scheme. This combination of factors is certainly sufficient to establish "substantial effect" on interstate commerce under the Act.

Id. at 744.

188. The implications of *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 425 U.S. 738 (1976), should not be overstated. The Court held only that the complaint could not be dismissed on its face, and that on further examination the providers involved might be shown not to have sufficient interstate impact. *Id.* at 746 & 747 n.5. It also attempted to avoid overruling *U.S. v. Oregon Medical Soc'y*, 343 U.S. 326 (1952). 425 U.S. at 747 n.5. Moreover, the hospital in *Hospital Bldg. Co.* had more interstate connections (for example, the out-of-state corporate parent) than do most health facilities.

189. *Hospital Bldg. Co.* suggests, and even encourages, a litigation strategy that may be employed by health care providers opposed to government controls: given the peculiar nature of government planning, cost limitation, and quality control programs—particularly the tendency to delegate responsibility for administration to private or quasi-public agencies, such as HSAs, PSROs and fiscal intermediaries—noncompetitive practices and restraints on trade can readily be

jurisdictional issue, however, appears to be relatively well settled,¹⁹⁰ at least in terms of the constitutional scope of federal antitrust legislation.¹⁹¹

A similar observation can be made for the scope of congressional authority to regulate health care providers specifically. While in the past the courts, as well as Congress, have had trouble linking health care delivery to interstate commerce in the application of antitrust leg-

alleged by providers aggrieved by those agencies' activities. Similarly, cost-controlling efforts by fiscal intermediaries to limit the costs of government programs or private insurance companies may be claimed to be price fixing and anticompetitive. *See* Group Life & Health Ins. Co. v. Royal Drug Co., 99 S. Ct. 1067 (1979). Or antitrust violations can be claimed in cooperative planning efforts among private providers or between providers and government agencies—efforts that have been *actively encouraged* by virtually all government planning programs since the early 1960s. *See, e.g.,* City of Fairfax v. Fairfax Hosp. Ass'n, 562 F.2d 280 (4th Cir. 1977), *vacated*, 435 U.S. 992 (1978). For that matter, the "Voluntary Effort" offered by the American Hospital Association to Congress in 1978 as an alternative to hospital cost containment legislation, *see* note 41 *supra*, may well violate federal antitrust laws, although the effort may be specifically exempted from enforcement activities.

190. *Hospital Building Co.* has been followed in a number of related but factually distinct cases.

In *Ballard v. Blue Shield*, 543 F.2d 1075 (4th Cir. 1976), *cert. denied*, 430 U.S. 922 (1977), a group of chiropractors sued individual physicians, the state medical society and the state Blue Cross/Blue Shield insurance plan, alleging that the failure to include chiropractors' services in insurance policy coverage was a result of Sherman Act violations. The Fourth Circuit held that after *Hospital Building Co.* the court "cannot say with certainty that the effect on commerce is so insubstantial as to deny federal jurisdiction." *Id.* at 1078. *See also* City of Fairfax v. Fairfax Hosp. Ass'n, 562 F.2d 280 (4th Cir. 1977), *vacated*, 435 U.S. 992 (1978).

In *Boddicker v. Arizona State Dental Ass'n*, 549 F.2d 626 (9th Cir.), *cert. denied*, 434 U.S. 825 (1977), the United States Court of Appeals for the Ninth Circuit took a similar view. In *Boddicker* the district court dismissed an action by local dentists alleging Sherman Act violations by local and state dental societies that required membership in the national dental association as a prerequisite to membership. Citing *Hospital Building Co.*, the court of appeals held that Sherman Act jurisdiction existed. *Id.* at 628. The court suggested that an effect on interstate commerce with respect to any one provider could be aggregated. *Id.* at 629 n.4. *See also* Zamiri v. William Beaumont Hosp., 430 F. Supp. 875 (E.D. Mich. 1977) (denial of staff privileges to individual physicians; jurisdiction based on receipt of federal funds).

191. Physicians' services are apparently no longer exempt from federal antitrust laws under the "learned professions" exemption. *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975); *AMA v. United States*, 130 F.2d 233 (D.C. Cir. 1942), *aff'd*, 317 U.S. 519 (1943). The Court in *Goldfarb*, however, intimated that, while not absolutely exempt, learned professions might be treated differently. 421 U.S. at 788 n.17.

Exemption from antitrust requirements might also be claimed under the McCarran-Ferguson Act's exemption of state-regulated insurance companies. *But see* Group Life & Health Ins. Co. v. Royal Drug Co., 99 S. Ct. 1067 (1979). *See also* Weller, *The McCarran-Ferguson Act's Antitrust Exemption for Insurance: Language, History, and Policy*, 1978 DUKE L.J. 587.

Of more relevance to health planning, cost containment, and cooperative arrangements such as the "Voluntary Efforts," *see* note 41 *supra*, will be the application of the *Parker v. Brown* exemption of state sanctioned restraints on trade. *Parker v. Brown*, 317 U.S. 341 (1942). *See generally* Blumstein & Calvani, *State Action as a Shield and a Sword in a Medical Services Antitrust Context: Parker v. Brown in Constitutional Perspective*, 1978 DUKE L.J. 389; Note, *Physician Influence: Applying Noerr-Pennington to the Medical Profession*, 1978 DUKE L.J. 701; Note, *Controlling Health Care Costs Through Commercial Insurance Companies*, 1978 DUKE L.J. 728.

islation, labor laws and other federal regulatory schemes,¹⁹² the courts have in recent years reversed the implications of their earlier decisions. The reasons for this new judicial attitude are abundantly clear: as the structure, financing, cost and nature of health care delivery have evolved in the last two decades, health care has moved from an activity that could be described as local in nature to a major, complex service industry with undeniable impact on interstate activities. If Congress wanted to exempt some or all health care providers from economic regulation in the 1930s or 1940s, there was ample justification for doing so. Even in the 1950s, before the real impact of technological medicine, government spending and regulatory programs, and the cost inflation spiral that characterized the 1960s and 1970s,¹⁹³ Congress could have found that health care delivery was a relatively unique industry, made up primarily of individual and institutional medical care providers with—arguably—incidental interstate ties.¹⁹⁴

All that, of course, has changed dramatically. The delivery of health care is now characterized by extensive private and public third-party payors, complex corporate provider organizations, and revenues and expenditures necessarily calculated in the millions of dollars¹⁹⁵—factors that modern courts have relied upon in finding the requisite connection between health care providers and interstate commerce.¹⁹⁶

While there may be room to argue that under close examination a given facility, certain small clinics or individual physicians in their private offices may not be involved in interstate commerce,¹⁹⁷ there is no doubt that Congress would be upheld were it to make the specific finding that health care providers are involved in interstate commerce or

192. For another example of a valid extension of federal commerce authority over health care providers, see *Marshall v. West Essex Gen. Hosp.*, 575 F.2d 1079 (3d Cir. 1978). The statute involved simply applies to any employer affecting interstate commerce. The court rejected the argument that the failure of Congress to include hospitals in its definition of employer required the negative implication that hospitals should not be included. The court found that the statute represented the full exercise of congressional commerce power and had no trouble finding that a hospital affected interstate commerce. *Id.* at 1082 n.4. See also *Occupational Safety and Health Act of 1970*, 29 U.S.C. §§ 651-678 (1976).

193. See Wing & Craige, this Symposium, at note 4.

194. See *id.* at notes 29-43.

195. See *id.* at notes 43-48.

196. See *Hospital Bldg. Co. v. Trustees of Rex Hosp.*, 425 U.S. 738 (1976).

197. Many of the factors considered in *Hospital Building Co.*, however, can be found even in the small clinic or the physician's office, and thus the physician's office, even if seen as local in nature, may still be regulated under the aggregation concept. See note 187 *supra* and the NLRB cases cited in note 176 *supra*. Given the latitude granted to congressional discretion in these matters, there is little doubt that Congress's decision to regulate the small clinic or physician's office would be upheld as constitutional.

that regulation of health care providers is necessary to achieve the objective of regulating an interstate activity. The discretion granted to Congress is too great, and the interstate nature of the modern health care delivery system is too obvious, to warrant any other conclusion.

There is little doubt that health care providers are subject to the congressional commerce authority and, therefore, that Congress can opt to impose regulatory controls or federal policy conditions on the activities of those providers, including the control of the costs of services or the prices charged. Once private conduct is found to be within the reach of the commerce authority, the courts have, with surprisingly little discussion, approved a variety of federal regulatory controls on that conduct, ranging from requirements of nondiscrimination¹⁹⁸ to the regulation of working conditions¹⁹⁹ to the fixing of prices charged or wages paid.²⁰⁰ The scope of congressional discretion to formulate the policy or objective of federal legislation enacted under this power is virtually unlimited.²⁰¹ The few courts that have even discussed the issue while considering the scope of the commerce authority have indicated that at best the means chosen by Congress need only be reasonably related to the objective sought.²⁰² In general, challenges to commerce-based legislation have either questioned the existence of a sufficient link between interstate commerce and the regulated activity²⁰³ or claimed that the commerce authority as applied affects other constitutionally protected interests, most notably state sovereignty.²⁰⁴ These challenges have not attacked the regulatory means or the objec-

198. See *Katzenbach v. McClung*, 379 U.S. 294 (1964); *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241 (1964).

199. See cases cited note 176 *supra*.

200. See cases cited notes 160 & 161 *supra*.

201. See note 166 *supra*.

202. See, e.g., *Katzenbach v. McClung*, 379 U.S. 294, 303-05 (1964). In *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241 (1964), the Court said:

We, therefore, conclude that the action of the Congress in the adoption of the Act as applied here to a motel which concededly serves interstate travelers is within the power granted it by the Commerce Clause of the Constitution, as interpreted by this Court for 140 years. It may be argued that the Congress could have pursued other methods to eliminate the obstructions it found in interstate commerce caused by racial discrimination. But this is a matter of policy that rests entirely with the Congress not with the courts. How obstructions in commerce may be removed—what means are to be employed—is within the sound and exclusive discretion of the Congress. It is subject only to one caveat—that the means chosen by it must be reasonably adapted to the end permitted by the Constitution.

Id. at 261-62.

203. See notes 161-63 *supra*.

204. See note 226 *infra*.

tive of the legislation.²⁰⁵

Thus, any of the regulatory controls that have been imposed by Congress on health care providers participating in federal programs under the conditional spending authority²⁰⁶ could be imposed on all health care providers engaged in interstate commerce—arguably all health care providers—if Congress opted to do so. Once the provider is linked to interstate commerce, Congress is free to regulate or set policy for that provider's activities within the wide bounds of discretion that it has traditionally been granted. For example, utilization review requirements imposed on all health care providers could be justified not only as an attempt to control the costs of government-financed health care services or in the terms necessary to sustain the regulation as an exercise of the spending authority, but also as an attempt to control the cost and quality of health care services in general, objectives that are presumably within the discretion of Congress once health care is linked to interstate commerce. Similarly, Congress could find that unnecessary capital expenditures would result in higher service costs or a maldistribution of resources and therefore require that all health care providers engaged in interstate commerce comply with the mandates of health planning programs or the requirements of state or federal certificate of need programs.

There is little doubt that cost containment programs such as those described earlier in this article could be constitutionally justified as an extension of the commerce authority.²⁰⁷ Whether billed as a temporary

205. The extent of congressional authority under the commerce clause has been examined in cases challenging federal wage and price controls. See *Fry v. United States*, 421 U.S. 542 (1975), distinguished in *National League of Cities v. Usery*, 426 U.S. 833, 854 (1976); *United States v. Pro Football, Inc.*, 514 F.2d 1396 (Emen. Ct. App. 1975); *Derwent v. Five Smalls, Inc.*, 499 F.2d 1320 (Emen. Ct. App.), cert. denied, 419 U.S. 996 (1974). But note that these cases generally raise other constitutional arguments and do not directly attack the authority to regulate prices in interstate commerce.

206. See text accompanying notes 59-62 *supra*.

207. It is worth noting that across-the-board wage and price controls for all industries "engaged" in interstate commerce have been enacted twice in the last 40 years, and both times these controls have survived constitutional challenge. In 1942, under its war powers, Congress enacted the Emergency Price Control Act, Act of Jan. 30, 1942, ch.26, 56 Stat. 23 (expired June 30, 1943); upheld in *Yakus v. United States*, 321 U.S. 414 (1944). In 1971, Congress enacted similar legislation under the authority of the commerce power, Economic Stabilization Act Amendments of 1971, Pub. L. No. 91-510, 85 Stat. 743, as amended by Pub. L. No. 93-261, 87 Stat. 27 (1973) (expired April 30, 1974), upheld in *Fry v. United States*, 421 U.S. 542 (1975).

Hospital cost containment represents a similar governmental exercise of power, but it is confined to a portion of a single industry that has been shown to have extraordinary effects on inflation in health care costs and the cost of living in general. See Wing & Crange, this Symposium, at notes 40-43.

A number of the earlier commerce power cases also involved regulatory programs that included maximum prices to be charged. See, e.g., *Wickard v. Filburn*, 317 U.S. 116 (1942).

measure pending the development of a more permanent solution to the problem of inflation or, as it now appears to be, a relatively permanent attempt to control costs,²⁰⁸ even a comprehensive hospital cost containment program would appear to be a reasonable means to achieve a permissible congressional purpose.²⁰⁹ Controls on hospital costs would have a substantial effect on the price of services and supplies, costs to patients, capital expenditures, revenues from insurance and government—all of the factors that courts have relied on in drawing the relationship between health care providers and interstate commerce.²¹⁰

Thus, President Carter's comprehensive cost containment proposal, parts of which might not have survived constitutional challenge if analyzed as an exercise of the spending authority,²¹¹ would be sustained if enacted as an exercise of the commerce authority.²¹²

D. Interstate Commerce and State Sovereignty

Congress' continued reluctance to use its interstate commerce powers to extend federal involvement in the delivery of health care may be based on real political constraints, but it is not required by any constitutional limitation on the scope of that authority standing alone. This is not meant to suggest, however, that there are not constitutional limitations on the commerce authority as applied to the delivery of health care; the commerce power is subject to various affirmative constitutional limitations on government authority.²¹³ As discussed earlier

208. See notes 8-10 *supra*.

209. The 1977 Carter proposal was limited to health facilities with 4,000 or more admissions per year. H.R. 5285, 95th Cong., 2d Sess. § 2(dd)(1), 124 CONG. REC. S18368-S18371 (daily ed. Oct. 12, 1978).

As a comparison, a 70-bed hospital would have on the average less than 2,500 admissions, whereas a 140-bed hospital would have approximately twice as many. See AMERICAN HOSPITAL ASSOCIATION, HOSPITAL STATISTICS 10 (Table III) (1977). But even if small hospitals were included, there is no doubt that the linkage to interstate commerce could be provided given the factors relied upon by modern courts. See note 187 *supra*. Note also that the NLRB has claimed jurisdiction over much smaller facilities. See note 176 *supra*.

210. See discussion of Hospital Bldg. Co. v. Trustees of Rex Hosp. and cases that have followed it at note 190 *supra*.

211. See text accompanying notes 110-12 *supra*.

212. None of the 1977 bills, however, included language specifically linking hospitals and interstate commerce.

213. While beyond the scope of this article, several other constitutional issues of relevance in this context can be suggested. Obviously, the requirements of procedural due process would have to be met by any federal regulatory efforts. Of more substantive importance, providers may also raise the argument that limiting their ability to expand or modernize existing facilities, or even their opportunity to provide services, is a "taking" of property. With regard to cost containment or regulatory controls of the type currently being used, the argument seems to lack merit, but more strenuous regulatory controls, particularly those that have the effect of closing or decertifying existing services, would raise more serious issues. For a discussion of the legal basis of *de jure*

with respect to the spending powers,²¹⁴ even if properly enacted under the interstate commerce authority, federal policy conditions or regulatory schemes may still be invalid if the federal regulation interferes too greatly with the sovereignty of state or local governments or offends judicial notions of federalism.

The exact parameters of this constitutional constraint are difficult to assess,²¹⁵ and predictions of future applications are necessarily speculative. The Supreme Court's ruling in *National League of Cities v. Usery*²¹⁶ and the decisions that have followed it²¹⁷, however, clearly require that the impact of commerce-based legislation on state and local government be given serious consideration, even if the basis for that consideration remains unclear. In the context of legislation that attempts to extend federal influence over the delivery of health care in ways that have not been attempted before, even a court with a narrow view of *National League of Cities* will be hard pressed to distinguish federal regulation of wages and working conditions from the regulation of capital expenditures by health care providers, limitations on revenues collected or other health care cost controls. Justice Rehnquist's admonitions concerning the adverse impact of federal minimum wage requirements on "States as States"²¹⁸ and the resulting imbalance in state and federal power are readily applied to cost containment strategies, and, in fact, a substantial impact on state and local government may exist—both in terms of a financial burden and a displacement of the state's decisionmaking autonomy. Unless exempted from federal policy conditions or regulatory controls, state and local governments as providers of hospital, clinic, and public health services will be substantially affected²¹⁹ if mandatory federal controls on costs are imposed or if the existing planning or policy conditions that are now imposed on

decertification, see Kopit, Krill & Bonnie, *Hospital Decertification: Legitimate Regulation or a Taking of Private Property?*, 1978 UTAH L. REV. 179. See also *United States v. Pro Football, Inc.*, 514 F.2d 1396 (Emer. Ct. App. 1975); *Derieux v. Five Smiths, Inc.*, 499 F.2d 1321, 1334-35 (Emer. Ct. App.), *cert. denied*, 419 U.S. 896 (1974).

A commerce-based regulatory scheme might also be challenged as interfering with a constitutional right to practice medicine, drawing on the right to privacy recognized in the abortion decisions. See, e.g., *Planned Parenthood v. Danforth*, 428 U.S. 52 (1976); *Doe v. Bolton*, 410 U.S. 179 (1973); *Roe v. Wade*, 410 U.S. 113 (1973). Similar arguments, however, have been uniformly rejected by the courts. See note 101 *supra*.

214. See text accompanying notes 113-56 *supra*.

215. See text accompanying notes 123-25 *supra*.

216. 426 U.S. 833 (1976).

217. Compare cases cited note 122 *supra* with *National League of Cities v. Usery*, 426 U.S. 833 (1976).

218. 426 U.S. at 845, 848, 851.

219. See text accompanying note 155 *supra*.

participants in Medicaid or Medicare or other federal programs were mandated under commerce-based legislation.²²⁰ Unlike federal regulation attached as conditions to spending programs, the option—realistic or not—to forego the funds and avoid the condition cannot be claimed to mitigate the effect of the commerce-based legislation. State or local governments would have no choice but to reduce or eliminate services, alter allocation decisions, or, in the case of a cost containment program, not collect revenue for costs incurred, shifting the impact of the cost to the local or state tax base. Whether analyzed in terms of the impact on “essential services”²²¹ or in terms of the overall balance of state and federal power,²²² substantial impact could be shown. Similarly, the state as administrator or regulator of health-related programs²²³ would be affected by mandatory federal regulatory controls on costs, particularly in regard to any state regulatory efforts.²²⁴ Even if federal regulatory controls are delegated to state or local agencies, as has been the pattern for virtually all previous federal regulatory efforts,²²⁵ federal requirements imposed on state regulatory programs, even though incident to federal funding for those programs, has not been readily accepted by state governments.²²⁶

The traditional opposition of state governments to federal inroads on state autonomy will certainly be fueled by any expansion of federal

220. See text accompanying notes 59-62 *supra*.

221. 426 U.S. at 845, 851. See also note 223 *infra*. Note that Justice Rehnquist does refer to hospitals in a manner that indicates he considers them traditional state services. *Id.* at 855.

222. See note 124 *supra*.

223. See text accompanying notes 126-35 *supra*.

224. But see note 154 *supra*.

225. See Wing & Craig, this Symposium, at notes 148-80.

226. See, e.g., *North Carolina ex rel. Morrow v. Califano*, 445 F. Supp. 532 (E.D.N.C. 1977), *aff'd mem.*, 435 U.S. 962 (1978); *Park East Corp. v. Califano*, 435 F. Supp. 46 (S.D.N.Y. 1977). Obviously, serious constitutional problems would be raised if Congress were to compel states as regulator/administrators to comply with a federal mandate. See discussion of a similar problem in Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196, 1243-50 (1977). See also *EPA v. Brown*, 431 U.S. 99 (1977); *District of Columbia v. Costle*, 567 F.2d 1091 (D.C. Cir. 1977); *Maryland v. EPA*, 530 F.2d 215 (4th Cir. 1975).

The short-term strategy for Congress may not be to require participation by all states in all regulatory efforts, particularly at a time when many programs must be described as experimental. Eventually, however, a national cost containing strategy will require the participation of most if not all states. Bypassing state government, Congress could create programs directly administered by the federal government, although politically this would be difficult to justify. Or Congress could delegate some administrative role to private organizations, as has been done in federal planning programs, but this approach would raise substantial delegation of authority issues. Thus far the issue has not been raised frequently in the planning context, probably because planning programs have rarely become fully operational. See, e.g., *Simon v. Cameron*, 337 F. Supp. 1380 (C.D. Cal. 1970).

authority over health care under the commerce authority, and if states and, to a lesser extent, local governments are not either exempted from federal regulatory efforts or satisfied with the role those efforts allow them, courts will be forced to interpret the as yet unsettled principles of federalism that apply in this context.

Since *National League of Cities*, most courts have treated the decision rather narrowly and tended to prefer a balancing approach to an analysis of the interplay of federal and state interests.²²⁷ Thus, the objectives, as well as the specific design of the federal regulatory efforts as they affect state and local governments as providers and as administrators or regulators, will likely be examined on a case by case basis rather than a delineation of certain state services or functions immune from federal regulatory efforts.

With regard to hospital cost containment, the Ninety-Fifth Congress was apparently willing to exempt public hospitals from coverage and to allow states with cost containment programs to be exempted from the program altogether. While the merits of these exemptions can obviously be questioned, they do indicate that consideration of state sovereignty or autonomy is a potent political limitation on congressional authority regardless of the exact magnitude of the constitutional basis for such an exemption.

Congress has not yet opted to apply its authority to regulate interstate commerce to the problems of health care costs or health resource allocation. Should Congress choose to do so, however, there is little doubt that the sweeping power to regulate that has been granted Congress under the commerce authority could be used as the basis for establishing regulatory controls over health care providers or for mandating adherence to health policy conditions. Federal programs enacted under the commerce authority to regulate labor practices, competition and working conditions have been extended to include health care providers, leaving little doubt that both individual and institutional providers are engaged in interstate commerce in the eyes of modern courts. Once an activity is included within the purview of the commerce authority, Congress is free to regulate that activity in nearly any way it sees fit, and, of course, in the case of regulatory programs such as hospital cost containment, even a court that did inquire into congressional purpose would find ample support for the national significance of health care problems.

227. See note 124 *supra*.

Notwithstanding the broad scope of Congress' discretion, however, should federal authority over interstate commerce be exercised in such a way that state or local governments are affected, either as providers of health care or as administrators of health-related programs, judicial scrutiny of federal discretion may be more carefully applied.

III. CONCLUSION

The ability of the current or future administrations to wield meaningful regulatory controls over health care delivery and its costs should not be overstated. The track record of the Carter Administration in securing congressional support for its legislative programs generally has not been impressive, but the results of its efforts to secure congressional support for its health care policies have been particularly dismal²²⁸—a witness to the politics of our times, but also to the considerable political opposition to the expansion of federal controls over health care delivery. To the extent that a health care regulatory strategy relies on new legislative authority, the current political obstacles are great.

Moreover, critics of regulatory strategies are quick to point out that, if history is any guide, any regulatory agency or program will likely be dominated by the very entities it seeks to control.²²⁹ Even if Congress or the Administration attempts to extend regulatory controls over health care, it remains to be seen whether the federal bureaucracy can effectively implement these controls if authorized, or even mandated, to do so. The past performance of federal agencies attempting to regulate health care providers has not been impressive either.

Even if the authority exists and serious efforts are made to carry it out, critics can still question whether the administrative or technical expertise exists to make sufficiently accurate—and legally defensible—decisions to carry out regulatory programs. The experience of the last decade indicates that it would take months, if not years, to tool up and operationalize a hospital cost containment or comparable program.²³⁰ Regulation requires data and the ability to compile and understand it; the technical ability to accomplish this task may not exist. Again, thus far regulatory efforts in the health care industry have been unimpressive.

228. See text accompanying notes 65-69 *supra*.

229. See Wing & Craige, this Symposium, at note 15.

230. See Schonbrun, this Symposium, at notes 35-55.

These reservations only provide more ammunition to the already powerful coalition of opponents of cost containment programs—the provider community, state and local governments, political conservatives, and even free market theorists opposed to a regulatory strategy, although sympathetic to the objective of such programs. But while it can be debated whether regulatory programs should be enacted or, if enacted, whether they will be successful, it is certain that the debate, better characterized as a battle, will take place. As an anxious and somewhat befuddled public looks on, the Ninety-Sixth Congress will be faced with major health policy choices, ranging from cutbacks in some federal spending programs to hospital cost containment programs to nationalized health insurance schemes. The opening salvos have been fired: President Carter has resubmitted his cost containment proposal²³¹ and indicated that he has modified his ambitions for national health insurance;²³² congressional liberals led by Senator Edward Kennedy have proposed a "Health Care for All Americans Act,"²³³ a plan that includes both comprehensive insurance coverage and extensive regulatory controls on costs and quality. Undoubtedly industry representatives are mixing with fiscal conservatives and other likely political allies to meet these proposals with a counter-volley of their own. The specifics of the proposals, and perhaps even the proposals themselves, will be altered and amended, but the basic issues will remain the same. As far as the politics of health care are concerned, the Ninety-Sixth Congress will look much like the Ninety-Fifth, as will—in all probability—those that follow through the next decade. Health insurance, cost controls, resource allocation regulation, and the direction and scope of government health spending will all be debated in a political battle with enormous implications and an unpredictable outcome.

The issues are easily blurred and discolored by the political process; even an aroused public will find it hard to coalesce around specific proposals or even the various ideological perspectives. Yet, barring overwhelming public support, it is hard to imagine that vigorous Administration efforts or a coalition of liberal political factions will gather enough momentum to overcome the political obstacles. As costs continue to rise at extraordinary rates and the problems of access to health care and the distribution of health resources become realities for more Americans, however, a confused, unfocused public will still indignantly

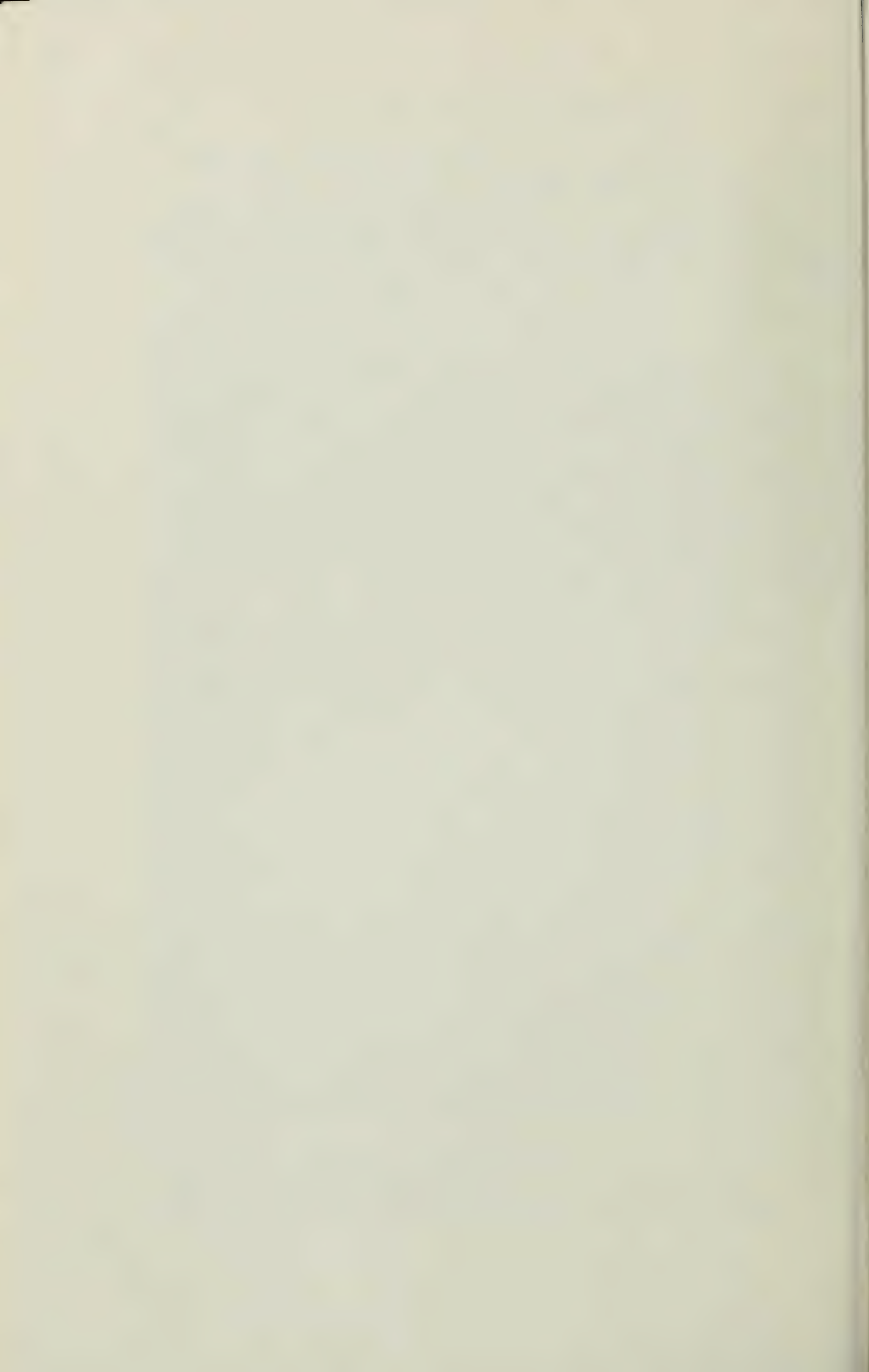
231. See text accompanying notes 69 & 70 *supra*.

232. See text accompanying notes 8-10 *supra*.

233. Press Release from the office of Senator Edward M. Kennedy (May 14, 1979).

demand that "something" be done; health care regulation will continue to be a major public policy dilemma.

Compared to the politics of health care regulation, the constitutional dimensions appear rather pale and straightforward. There are loose, and loosely defined, limits on what Congress can do, but basically Congress is constitutionally free to regulate health care costs, resource allocation and quality in any way that it sees fit. Unless interpretations of the basic division of authority between the legislative and judicial branches, or of the power of the federal government over private and, perhaps, state and local interests, change drastically, the post-1930 judicial philosophy that has deferred almost completely to legislative discretion in matters of economic and social legislation should embrace the concept of congressionally imposed federal regulation of health care without difficulty. Substantial constitutional issues requiring more rigorous judicial attention lie ahead, but they generally involve the incidentals of how regulatory programs are carried out, not whether controls can be established.



NOTE

Constitutional Law—*Rennie v. Klein*: Constitutional Right of Privacy Protects A Mental Patient's Refusal of Psychotropic Medication

Involuntarily committed mental patients have been subjected to a wide variety of organic therapies,¹ ranging in intrusiveness² from minor tranquilizers to psychosurgery.³ Until very recently, mental institutions and their psychiatrists were permitted virtually unlimited authority to impose any of these treatments on unconsenting patients. A growing recognition of mental patients' rights has caused some legislatures and courts to take tentative steps to curb psychiatric discretion. Several states have enacted legislation⁴ restricting the use of electroconvulsive therapy,⁵ psychosurgery,⁶ and other "extreme" forms of treatment.⁷ In

1. "Organic therapies" are "procedures which affect or alter through electrochemical or surgical means a person's thought patterns, sensations, feelings, perceptions, . . . or mental activity generally" or "conditioning techniques using the effects of electrical or chemical intervention into mental functioning as part of the conditioning program." Shapiro, *Legislating the Control of Behavior Control: Autonomy and the Coercive Use of Organic Therapies*, 47 S. CALIF. L. REV. 237, 244 n.8 (1974).

2. It has been suggested that the "intrusiveness" of a therapy or program is a function of the following criteria: (1) the extent to which the effects of the therapy are reversible; (2) the extent to which the resulting psychic state is "foreign" to the subject, rather than simply a restoration of his prior psychic state; (3) the rapidity with which the effects occur; (4) the scope of the change in the total "ecology" of the mind's functions; (5) the extent to which one can resist acting in ways impelled by the psychic effects of the therapy; (6) the duration of the change. *Id.* at 262.

3. See Plotkin, *Limiting the Therapeutic Orgy: Mental Patients' Right to Refuse Treatment*, 72 NW. U.L. REV. 461, 465-82 (1977). See also Note, *Conditioning and Other Technologies Used to "Treat?" "Rehabilitate?" "Demolish?" Prisoners and Mental Patients*, 45 S. CALIF. L. REV. 616 (1972).

4. For a comprehensive statutory survey, see Plotkin, *supra* note 3, at 504 app. The inadequacies of existing regulatory schemes are discussed in *id.* at 498-500.

5. See, e.g., CAL. WELF. & INST. CODE §§ 5325(f), 5326.7-.95 (West Cum. Supp. 1979); N.J. STAT. ANN. § 30:4-24.2(d)(2) (West Cum. Supp. 1978); N.C. GEN. STAT. § 122-55.6 (Cum. Supp. 1978). See generally Note, *Regulation of Electroconvulsive Therapy*, 75 MICH. L. REV. 363 (1976).

6. See, e.g., CAL. WELF. & INST. CODE §§ 5325(g), 5326.6 (West Cum. Supp. 1979); N.J. STAT. ANN. § 30:4-24.2(d)(2) (West Cum. Supp. 1978); N.C. GEN. STAT. § 122-55.6 (1974); OR. REV. STAT. §§ 426.385(2), 426.700-.760 (1977).

7. See, e.g., MONT. REV. CODES ANN. § 38-1322 (Cum. Supp. 1977) (prohibits subjecting patients to "lobotomy, aversive [sic] reinforcement conditioning, or other unusual or hazardous treatment procedures without their express and informed consent"); VA. CODE § 37.1-84.1(5) (1976) (confers right to impartial review prior to implementation of "hazardous treatment or irreversible surgical procedures").

In early 1978, the California Assembly passed a bill providing that "voluntarily admitted mental patients shall have the right, except in emergencies, to refuse treatment with psychotropic drugs." The bill failed to pass the State Senate. See Flynn, *Psychotropic Drugs and Informed Consent: A Report from California*, 30 HOSPITAL & COMMUNITY PSYCH. 51 (1979).

the absence of statutory protection, courts have adumbrated a right to refuse treatment based on either common-law or constitutional grounds.⁸ Most cases supporting a right to refuse treatment for mental patients have concerned "therapies" that were highly intrusive and experimental or punitive in nature.⁹ In *Rennie v. Klein*,¹⁰ however, the federal district court in New Jersey was presented with a mental patient's refusal of psychotropic¹¹ medication, the "conventional" treatment for his diagnosed disorder. The court held that mental patients have, in the absence of an emergency, a right to refuse treatment, including drug therapy, which is founded on the constitutional right of privacy.¹²

Plaintiff John E. Rennie, a "highly intelligent" middle-aged man, was first admitted to Ancora Psychiatric Hospital, a New Jersey state institution, in 1973. Depressed and suicidal, he was diagnosed as a paranoid schizophrenic, treated with an antipsychotic drug and released. During the next three years, Rennie was readmitted eleven times, sometimes voluntarily, sometimes under compulsion. His behavior during confinement was erratic: he was alternately depressed and suicidal, then manic and homicidal. At various times hospital psychiatrists tried both anti-psychotic medication and lithium, a drug used in the treatment of mania. Rennie sometimes refused to take the prescribed medication; at other times, he cooperated.¹³

Rennie's most recent and lengthy stay was initiated through an involuntary commitment proceeding in August 1976.¹⁴ In early December 1977, the hospital staff had concluded that Rennie was highly homicidal, and that his general condition was deteriorating. A decision was made to administer psychotropic medication without his consent.¹⁵

8. See notes 50-54 and accompanying text *infra*.

9. See notes 57-59 and accompanying text *infra*.

10. 462 F. Supp. 1131 (D.N.J. 1978).

11. "Psychotropic" is a general term describing drugs affecting the mind, behavior, intellectual functions, perception, moods and emotion. Winick, *Psychotropic Medication and Competence to Stand Trial*, 1977 AM. B. FOUNDATION RESEARCH J. 769, 771 n.8. The court in *Rennie* used the term to refer to a particular class of psychotropic drugs: those used to treat schizophrenia and related psychoses. 462 F. Supp. at 1134-36, 1139. It is more accurate to refer to drugs in this group as "antipsychotics" or "neuroleptics." See Winick, *supra*, at 779-84. See also S. HALLECK, *THE TREATMENT OF EMOTIONAL DISORDERS* 193-210 (1978). The more precise terminology will be used in this Note, where appropriate.

12. The court also declared that, absent an emergency, some due process hearing is constitutionally required prior to the forced administration of medication. See note 39 *infra*.

13. 462 F. Supp. at 1135-36.

14. *Id.* at 1136.

15. After meeting with Rennie's treatment team, the Medical Director of Ancora sought and received permission from the Attorney General's Office to forcibly treat the patient. *Id.* at 1139.

The purpose was to prevent Rennie from harming other patients, staff, and himself and to "ameliorate his delusional thinking pattern."¹⁶ Two weeks after a prolixin¹⁷ regimen was initiated, Rennie filed a motion for a preliminary injunction to prevent defendant psychiatrists and hospital officials from forcibly administering drugs to him in the absence of an emergency.¹⁸ The complaint was grounded on section 1983 of the Civil Rights Act.¹⁹

The court conducted fourteen days of hearings, during which both parties presented extensive,²⁰ and frequently conflicting,²¹ psychiatric testimony. The court made the following findings of fact: (1) "[P]sychotropic²² drugs are widely accepted in current psychiatric practice. . . . They are the treatment of choice for schizophrenics today."²³

The hospital's caution was apparently inspired by the prior involvement of the Public Advocate's Office in Rennie's case. *Id.* at 1136.

16. *Id.* at 1139.

17. Prolixin is the brand name for the generic fluphenazine, a psychotropic drug belonging to the phenothiazine family of neuroleptics. S. HALLECK, *supra* note 11, at 195 (Table 1). The drug is available in oral or injectable forms. Two of the injectable compounds, fluphenazine enanthate and fluphenazine decanoate, are effective for an extended duration, sometimes as long as six weeks. "Because of their prolonged effects, the enanthate and the decanoate forms are primarily used in treating chronic patients unwilling or unable to take regular oral medication." *Id.* at 198-99. See generally Zander, *Prolixin Decanoate: Big Brother by Injection?*, 5 J. PSYCH. & L. 55 (1977).

18. 462 F. Supp. at 1134.

19. 42 U.S.C. § 1983 (1976).

20. Testimony was taken from three Ancora psychiatrists, the Director of the State Division of Mental Health and Hospitals, three psychiatrists from outside the state system produced by plaintiff, and two outside psychiatrists produced by defendant. 462 F. Supp. at 1134.

21. On the threshold issue of the patient's diagnosis, disagreement among the experts was particularly intense. The court summarized the testimony as follows:

Drs. Heller [defendant's outside consultant] and Bugoan [hospital psychiatrist] believe plaintiff is schizophrenic. . . . Drs. Ortanez and Pepernik [hospital psychiatrists] give a diagnosis of schizophrenia, affective type. . . . Ortanez agrees that plaintiff has also shown a manic depression symptoms [*sic*] at times. . . . Dr. Stinnett [defendant's most prestigious outside consultant] diagnoses plaintiff as manic depressive, but offers schizoaffective disorder as a possible alternative diagnosis. . . . Finally, Drs. Limoges and Pepper [plaintiff's psychiatrists] feel that plaintiff suffers only from manic depression.

Id. at 1139.

On the unreliability of psychiatric diagnosis, see Ennis & Litwack, *Psychiatry and the Presumption of Expertise: Flipping Coins in the Courtroom*, 62 CALIF. L. REV. 693 (1974). See also O'Connor v. Donaldson, 422 U.S. 563, 584 (1975) (Burger, C.J., concurring) ("There can be little responsible debate regarding 'the uncertainty of diagnosis in this field and the tentativeness of professional judgment.'" (citing Greenwood v. United States, 350 U.S. 366, 375 (1956))).

22. Note that here, and in the other findings of fact, the court is using the general term "psychotropics" to refer to antipsychotic drugs, a particular class of psychotropics. See note 11 *supra*.

23. 462 F. Supp. at 1137. Accord, P. MAY, TREATMENT OF SCHIZOPHRENIA 258 (1968); Winick, *supra* note 11, at 780-81. Cf. S. HALLECK, *supra* note 11, at 183 (antipsychotic drugs are the preferred biological treatment under carefully delineated circumstances); DuBose, *Of the Parens Patriae Commitment Power and Drug Treatment of Schizophrenia: Do the Benefits to the*

(2) "[A]ll of the psychotropic drugs cause dysfunctions of the central nervous system . . . as well as other side effects. . . . A potential permanent side effect of prolixin and other antipsychotic medication is tardive dyskinesia."²⁴ (3) "Plaintiff is acutely psychotic at times."²⁵ Aside from [plaintiff's] adverse reaction to psychotropics, the best course of treatment . . . would combine psychotropic medication with lithium and an antidepressant. However, the position that he has no fixed delusions, thus making use of a psychotropic unnecessary, is, at the least, a reasonable proposition."²⁶ (4) Rennie suffers from many of the side effects associated with psychotropic medication, including preliminary symptoms "possibly indicative that tardive dyskinesia may develop if medication is continued."²⁷ (5) "[P]sychotropic drugs are less efficacious in a hostile or negative environment."²⁸ (6) Rennie's refusal of prolixin is "not a product of his mental disorder."²⁹

The language of the New Jersey statutes, as interpreted in a recent state court decision,³⁰ implicitly denied the right of an involuntarily confined mental patient to refuse medication.³¹ Thus plaintiff's section

Patient Justify Involuntary Treatment?, 60 MINN. L. REV. 1149 (1976) (benefits of treatment have been overstated; hazards have been disregarded).

24. 462 F. Supp. at 1137-38. For a description of the side effects of antipsychotic drugs, including tardive dyskinesia, see text accompanying notes 92-97 *infra*.

25. 462 F. Supp. at 1140.

26. *Id.* The court had earlier found that lithium carbonate, in conjunction with an antidepressant, is the preferred treatment for bipolar manic depression. *Id.* at 1138. *Accord*, L. GOODMAN & A. GILMAN, *THE PHARMACOLOGICAL BASIS OF THERAPEUTICS* (5th ed. 1975); S. HALLECK, *supra* note 11, at 217-21. Rennie's condition was diagnosed as manic depression by several of the examining psychiatrists. See note 21 *supra*.

27. 462 F. Supp. at 1140-41. The court noted the following side effects experienced by the plaintiff: blurred vision, dry mouth, decreased blood pressure, uncontrollable tremors, involuntary wormlike movements of the tongue. The latter dysfunction is associated with tardive dyskinesia.

28. *Id.* at 1141. *Accord*, *O'Connor v. Donaldson*, 422 U.S. 563, 579 (1975) (Burger, C.J., concurring).

29. 462 F. Supp. at 1141. Psychiatric testimony on this question was conflicting. The court's summary reflects the difficulty of the capacity issue:

John Rennie's psychiatric problems are of a cyclical nature, so that on some days he is psychotic. Dr. Pepper [plaintiff's expert] testified that plaintiff's refusal of prolixin is not a product of his mental disorder. . . . However, Dr. Stinnett [defendant's expert] found that during his examination on February 25, 1978, Mr. Rennie was not capable of making a decision on treatment in his best interests. . . . The court feels that Dr. Pepernik's [*sic*] assessment is most accurate, and that Mr. Rennie's wishes should be taken into account on any treatment decision. But the court finds that his capacity to participate in the refusal of medicine or the choice of medicine is somewhat limited, depending on the day.

Id. (citations omitted).

30. *In re Hospitalization of B.*, 156 N.J. Super. 231, 383 A.2d 760 (1977).

31. The 1975 amendments to the civil commitment statute include an enumeration of the rights of mental patients. One provision specifically regulates the use of drugs:

Each patient in treatment shall have the following rights . . . :

1983 action was premised on the unconstitutionality of the state scheme. The court considered three substantive rights under the United States Constitution allegedly violated by New Jersey's system of coercive drug treatment: a right to be free from cruel and unusual punishment under the eighth amendment; a right to freedom of thought and expression under the first amendment; and a right to privacy. In the circumstances of the case before it, the court found that forced medication would not infringe Rennie's eighth³² or first amendment³³ rights. The court did find, however, that the right to privacy protected his refusal of medication, in the absence of an emergency.³⁴

The court noted that "[t]he constitutional right to refuse treatment cannot be absolute."³⁵ In appropriate circumstances, the state's interest

(1) To be free from unnecessary or excessive medication. No medication shall be administered unless at the written order of a physician. . . . Medication shall not be used as punishment, for the convenience of staff, as a substitute for a treatment program, or in quantities that interfere with the patient's treatment program. Voluntarily committed patients shall have the right to refuse medication.

N.J. STAT. ANN. § 30.4-24.2(d) (West Cum. Supp. 1978). The New Jersey Superior Court interpreted the last sentence to mean, by clear implication, that "[i]nvoluntarily committed patients . . . do not have the right to refuse medication." *In re Hospitalization of B.*, 156 N.J. Super. 231, 236, 383 A.2d 760, 763 (1977).

32. Rennie's eighth amendment claim failed because defendants were able to show that prolixin, a drug of proven effectiveness, was "an integral component of an overall treatment program. While the side effects of prolixin are serious, they are not *unnecessarily* harsh in light of the potential benefits Prolixin was justifiably administered as treatment, not punishment." 462 F. Supp. at 1143. The court distinguished this case from those that involved drugs with no proven therapeutic value and unnecessarily harsh side effects, *e.g.*, *Knecht v. Gillman*, 488 F.2d 1136, 1138, 1140 (8th Cir. 1973) (apomorphine), and those in which drugs were used for punitive rather than therapeutic purposes, *e.g.*, *Nelson v. Heyne*, 491 F.2d 352, 356-57 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974); *Mackey v. Procunier*, 477 F.2d 877 (9th Cir. 1973); *Pena v. New York State Div. for Youth*, 419 F. Supp. 203, 207 (S.D.N.Y. 1976). *Cf.* *Welsch v. Likins*, 373 F. Supp. 487, 503 (D. Minn. 1974) (excessive use of tranquilizing medication as a means of controlling behavior, not mainly as a part of therapy, may be eighth amendment violation).

33. The court found no evidence that the hospital administered the drugs in order to suppress statements critical of the institution. Nor did the court consider the alleged interference with Rennie's thought processes and freedom to generate ideas a first amendment violation. Rennie's ability to perform on intelligence tests was unimpaired even though he complained that prolixin dulled his senses and made it difficult for him to speak. The court contrasted these temporary but relatively minor complications with the drastic effects of psychosurgery. 462 F. Supp. at 1143-44.

34. *Id.* at 1144-45. "Emergency" was not defined in the original opinion. In response to requests by both parties, the court explained the concept in a supplemental opinion.

Emergency signifies a sudden, significant change in the plaintiff's condition which creates danger to the patient himself or to others in the hospital. While restraints can always eliminate this danger, . . . this is a realistic alternative only if a few hours' confinement are adequate to calm the plaintiff. Otherwise the hospital is not required to place the plaintiff in permanent restraints rather than medicate.

If normal administrative channels fail to provide the plaintiff relief, he may, after 72 hours, seek a temporary restraining order to halt the forcible medication. After the restraining order is issued, the court will immediately schedule a preliminary injunction hearing. *Id.* at 1154 (citations omitted).

35. *Id.* at 1145.

in treatment will override the patient's right to refuse medication. The court listed a number of factors relevant to the inquiry. First, the state's police power may justify forcible treatment when a failure to treat would endanger other patients and staff.³⁶ Second, if, after a hearing, the patient is found to be incompetent to make a decision about treatment, the state may use its *parens patriae* authority as a basis for medication.³⁷ Third, the court should consider whether any less intrusive treatment methods are available.³⁸ Fourth, the court must weigh the risks of permanent side effects from the proposed treatment.³⁹

In holding that a mental patient has a constitutional right, in the absence of an emergency, to refuse psychotropic medication, the *Renie* court moved beyond established precedent. Yet the decision follows logically from the emerging right of privacy recognized by courts and commentators. The privacy right protects bodily as well as mental autonomy, both of which are infringed by the state's forcible administration of psychotropic drugs.

The right to bodily autonomy is perhaps the core of the privacy concept.⁴⁰ Nonconsensual touching of the body has long been a tort at common law.⁴¹ Further, the Supreme Court has indicated that the fourth and fourteenth amendments may prohibit unwarranted bodily intrusions by the state.⁴² The Constitution, however, does more than shield the person from physical invasions; it affirmatively protects the individual's right to make fundamental decisions about his or her body.

36. *Id.*

37. *Id.* at 1145-46.

38. *Id.* at 1146-47.

39. *Id.*

In dictum, the court found merit in plaintiff's due process challenge to the state's procedures for forcible medication, and specified that before coercive drug treatment is initiated, the state provide "some due process hearing." At this hearing, "patients must be informed of and participate in the decision-making aspects of their treatment"; patients are entitled to the assistance of a lawyer and an independent psychiatrist, which the state must provide if the patient cannot afford them; and the patient's lawyer and psychiatrist must have access to hospital records. *Id.* at 1147-48.

40. See Gerety, *Redefining Privacy*, 12 HARV. C.R.-C.L. L. REV. 233, 263-66 (1977).

41. W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 34-37 (4th ed. 1971).

42. *Terry v. Ohio*, 392 U.S. 1, 9 (1968) (stop and frisk) (quoting *Union Pac. Ry. v. Botsford*, 141 U.S. 250, 251 (1891) ("No right is held more sacred, or is more carefully guarded . . . than the right of every individual to the possession and control of his own person, free from all restraint or interference of others, unless by clear and unquestionable authority of law."); *Schmerber v. California*, 384 U.S. 757, 772 (1966) (blood sample) ("The integrity of an individual's person is a cherished value of our society."); see also *Breithaupt v. Abram*, 352 U.S. 432, 442, 443-44 (1957) (blood sample) (Warren, C.J., dissenting; Douglas, J., dissenting); *Rochin v. California*, 342 U.S. 165, 172 (1952) (forcible administration of emetic).

without state interference. The Supreme Court, in *Griswold v. Connecticut*,⁴³ thus held that a constitutional right of privacy prevents the state from interfering with a married couple's decision to use contraceptives. In *Eisenstadt v. Baird*, the Court extended *Griswold*'s protection to the unmarried.⁴⁴ Then, in *Roe v. Wade*, the Court proclaimed that the "right of privacy . . . is broad enough to encompass a woman's decision whether or not to terminate her pregnancy."⁴⁵

The right to mental autonomy or mental privacy is intimately associated with the first amendment. In *Stanley v. Georgia*,⁴⁶ the Court struck down a state statute making mere possession of obscene matter a crime. The statute was held to violate the defendant's "fundamental" rights to "receive information and ideas, regardless of their social worth" and "to be free . . . from unwarranted governmental intrusions into one's privacy."⁴⁷ The Court quoted the memorable passage from Justice Brandeis' dissent in *Olmstead v. United States*: "The makers of the Constitution . . . sought to protect Americans in their beliefs, their thoughts, their emotions and their sensations. They conferred, as against the Government, the right to be let alone—the most comprehensive of rights and the right most valued by civilized man."⁴⁸ "Our whole constitutional heritage," Brandeis declared, "rebels at the thought of giving government the power to control men's minds."⁴⁹

The constitutional right of privacy, as a safeguard of the individual's bodily autonomy, is clearly implicated by state-imposed medical intervention. At common law, the physician normally may not treat

43. 381 U.S. 479, 485-86 (1965).

44. 405 U.S. 438, 453 (1972).

45. 410 U.S. 113, 153 (1973). *Roe* barred state interference with the abortion decision during the first trimester of pregnancy, but permitted state regulation in the second and third trimesters. *Id.* at 164-65. The court in *Roe* traced the evolution of a constitutional right of personal privacy as far back as *Union Pac. Ry. v. Botsford*, 141 U.S. 250 (1891). 410 U.S. at 152. But note the Court's limiting language:

"The privacy right . . . cannot be said to be absolute. In fact, it is not clear to us that the claim asserted by some amici that one has an unlimited right to do with one's body as one pleases bears a close relationship to the right of privacy previously articulated in the Court's decisions. The Court has refused to recognize an unlimited right of this kind in the past.

Id. at 154 (citing *Buck v. Bell*, 274 U.S. 200 (1927) (sterilization); *Jacobson v. Massachusetts*, 197 U.S. 11 (1905) (vaccination)).

46. 394 U.S. 557 (1969).

47. *Id.* at 563.

48. *Id.* at 564 (quoting *Olmstead v. United States*, 277 U.S. 438, 478 (1928) (Brandeis, J., dissenting)).

49. *Id.* at 565 (quoting *Olmstead v. United States*, 277 U.S. 438, 478 (1928) (Brandeis, J., dissenting)).

the patient without first obtaining his or her informed consent;⁵⁰ when those seeking to impose treatment are officers of the state, the common-law prohibition takes on constitutional dimensions. With increasing frequency, courts have found a right to refuse treatment for physical disorders based implicitly or explicitly on the constitutional privacy right. Such a right has been held to protect a prisoner's refusal of medically indicated surgery⁵¹ or a competent patient's decision to decline a life prolonging operation, even if the decision was considered "irrational"⁵² or "unwise, foolish, or ridiculous."⁵³ In the highly publicized "right-to-die" cases, the constitutional right of privacy was interpreted to permit or even to compel the termination of unwanted life-support systems.⁵⁴

The weight of authority thus supports a general constitutional right to refuse medical treatment, based on the right of privacy. With one exception,⁵⁵ however, no court has squarely faced the more specific

50. 61 AM. JUR. 2d *Physicians, Surgeons, and Other Healers* § 152 (1972). Failure to secure the patient's consent may expose the treating physician to liability for negligence, *id.* at § 154, or battery, *id.* at § 155. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 116-18 (4th ed. 1971). See also *Scott v. Plante*, 532 F.2d 939, 946 (3rd Cir. 1976); *Winters v. Miller*, 446 F.2d 65, 68 (2d Cir. 1971); Szasz, *Involuntary Psychiatry*, 45 U. CIN. L. REV. 347, 357 (1976).

51. *Runnels v. Rosendale*, 499 F.2d 733 (9th Cir. 1974) (hemorrhoidectomy).

52. *Lane v. Candura*, — Mass. App. Ct. —, 376 N.E.2d 1232, 1235 (1978) (amputation of leg afflicted with gangrene). Accord, *In re Quackenbush*, 156 N.J. Super. 282, 383 A.2d 785 (Morris County Ct. 1978) (amputation of both legs).

53. *In re Yetter*, 62 Pa. D. & C.2d 619, 623 (C.P., Northampton County, June 6, 1973) (biopsy and surgery for cancer). See also *In re President of Georgetown College, Inc.*, 331 F.2d 1010, 1017 (D.C. Cir. 1964) (denial of rehearing) (Burger, J., dissenting).

Where minor children are not involved, courts have refused, on first amendment grounds, to order blood transfusions over the religious objections of a competent adult, even though death was imminent. See, e.g., *In re Osborne*, 294 A.2d 372 (D.C. 1972); *In re Brooks*, 32 Ill. 2d 361, 205 N.E.2d 435 (1965); *In re Melideo*, 88 Misc. 2d 974, 390 N.Y.S.2d 523 (Sup. Ct. 1976). Cf. *In re President of Georgetown College, Inc.*, 331 F.2d 1000 (D.C. Cir.) (single judge), *cert. denied*, 377 U.S. 978 (1964) (emergency blood transfusion ordered over patient's religious objections; patient had infant child and was apparently incompetent). But cf. *John F. Kennedy Memorial Hosp. v. Heston*, 58 N.J. 576, 279 A.2d 670 (1971) (transfusion ordered for unconscious 22-year old, over mother's religious objections). See generally Annot., 9 A.L.R.3d 1391 (1966).

54. *Superintendent of Belchertown State School v. Saikewicz*, 370 N.E.2d 417 (Mass. 1977); *In re Quinlan*, 70 N.J. 10, 355 A.2d 647 (1976). See also *Satz v. Perlmutter*, 362 So. 2d 160 (Fla. App. 1978).

55. Two Minnesota county probate courts have rendered conflicting decisions on whether a patient has a right to refuse prolixin treatment. The Minnesota Supreme Court had previously held that a hearing was constitutionally required before "more intrusive forms of treatment" could be imposed on an unconsenting patient. *Price v. Sheppard*, 307 Minn. 250, 239 N.W.2d 905 (1976). Finding the use of prolixin decanoate an "intrusive form of psychiatric treatment," one probate court upheld the patient's right to refuse prolixin treatment, based on the constitutional right of privacy. *In re Cleo Lundquist*, No. 140151 (Ramsey County, Minn. P. Ct., April 30, 1976), reprinted in Zander, *supra* note 17, at 73-75. Less than two months later, another probate court reached the opposite conclusion. *In re Paul Fussa*, No. 66110 (Hennepin County, Minn. P. Ct.). The Minnesota Supreme Court refused to review the decision. See Zander, *supra* note 17 at 65-66.

issue presented in *Rennie* of whether an involuntarily committed mental patient has a constitutional right to refuse psychotropic medication.⁵⁶ In extending the privacy protection to Rennie's refusal, the New Jersey District Court made two critical affirmations: first, that the constitutional right to refuse treatment survives involuntary commitment to a mental institution; and second, that the right encompasses the refusal of a widely accepted form of therapy.

Several courts have found that the right of privacy protects an involuntarily confined mental patient's decision to refuse certain kinds of psychiatric treatment. In the 1972 landmark case of *Wyatt v. Stickney*,⁵⁷ a federal district court in Alabama proclaimed that mental patients have a constitutional right "not to be subjected to treatment procedures such as lobotomy, electro-convulsive treatment, aversive [*sic*] reinforcement conditioning or other unusual or hazardous treatment procedures without their express and informed consent."⁵⁸ Chief Judge Johnson did not, however, indicate which constitutional rights were affected by nonconsensual treatment. Other courts, building on *Wyatt*, have been more specific: they have tried to anchor the mental patient's right to refuse highly intrusive or experimental therapies in particular constitutional guarantees, including the right of privacy.⁵⁹

56. Two cases in the Third Circuit had raised the issue without resolving it. In *Scott v. Plante*, 532 F.2d 939 (3rd Cir. 1976), the court of appeals held that a mental patient had stated a claim for relief when he alleged that his constitutional rights had been violated by forcible treatment with psychotropic drugs. Plaintiff's constitutional claims paralleled those subsequently made by Rennie, but the *Scott* court, unlike the *Rennie* court, was reluctant to base its decision on the right of privacy. It suggested three "conceivable constitutional deprivations" arising from plaintiff's alleged forced treatment: (1) interference with first amendment rights; (2) denial of due process; and (3) cruel and unusual punishment. In a footnote, the court cautiously added: "A possible fourth constitutional deprivation might include invasion of the inmate's right to bodily privacy. . . . The scope of such a right, however, remains ill-defined." 532 F.2d at 946. A subsequent opinion by a Federal district court in Pennsylvania was only slightly less circumspect. In denying defendant's motion to dismiss, the court stated: "[W]e believe that involuntary administration of drugs which have a painful or frightening effect can amount to cruel and unusual punishment, in violation of the Eighth Amendment. . . . It has also been suggested that such medication amounts to an unwarranted governmental intrusion into the patient's thought processes in violation of his constitutional right to privacy." *Souder v. McGuire*, 423 F. Supp. 830, 832 (M.D. Pa. 1976) (citing *Scott v. Plante* and *Mackey v. Procunier*, 477 F.2d 877 (9th Cir. 1973)). Cf. *Naughton v. Bevilacqua*, 458 F. Supp. 610, 617-18 (D.R.I. 1978) (administration of phenothiazines to voluntarily confined mentally retarded patient after repeated instruction by patient's parents regarding patient's adverse reactions to drugs and directions by patient's parents not to administer the drugs, constitutes violation of patient's constitutional right to safe and humane environment) (dictum).

57. 344 F. Supp. 387 (M.D. Ala. 1972), *aff'd sub nom.*, *Wyatt v. Aderholt*, 503 F.2d 1305 (5th Cir. 1974).

58. *Id.* at 380.

59. See *Mackey v. Procunier*, 477 F.2d 877, 877-78 (9th Cir. 1973) (forcible administration of succinylcholine, a "breath-stopping and paralyzing 'fright drug'" could "raise serious constitutional questions respecting cruel and unusual punishment or impermissible tinkering with the

These decisions implicitly reject the traditional view that involuntarily confined mental patients are presumptively incompetent to make choices about treatment. According to the conventional wisdom,⁶⁰ the psychiatrist's judgment is properly substituted for the patient's because the latter's ability to make decisions is impaired by mental illness. Cases upholding the nonpsychiatric patient's right to decline treatment for physical disorders,⁶¹ premised as they are on a *competent* refusal,⁶² are seen as irrelevant.

Yet modern statutes explicitly distinguish the judicial commitment order from a finding of legal incompetency.⁶³ In New Jersey, for example, "[n]o patient may be presumed to be incompetent because he has been examined or treated for mental illness, regardless of whether such evaluation or treatment was voluntarily or involuntarily received."⁶⁴ The legislative trend reflects the consensus of modern psychiatric and legal opinion⁶⁵ that mental illness requiring hospitalization does not in itself indicate incapacity to make rational decisions.⁶⁶

mental processes") (citing *Eisenstadt v. Baird*, *Stanley v. Georgia*, and *Roe v. Wade*) (emphasis added); *Price v. Sheppard*, 307 Minn. 250, 239 N.W.2d 905 (1976) (electroconvulsive treatment); cf. *Kaimowitz v. Michigan Dept. Mental Health*, No. 73-19434-AW (Mich. Cir. Ct., Wayne Cty., July 10, 1973) (involuntarily confined mental patient unable to give informed consent to experimental psychosurgery).

60. See, e.g., *Whitree v. State*, 56 Misc. 2d 693, 290 N.Y.S.2d 486 (Ct. Cl. 1968). The court in that case rejected the defense, proffered by hospital officials, to a psychiatric inmate's claim that he had not been given proper drug treatment. "We find that the reason for not using such drugs was that Whitree refused them. We consider such reason to be illogical, unprofessional and not consonant with prevailing medical standards." *Id.* at 707, 290 N.Y.S.2d at 501. See also *Anonymous v. State*, 17 App. Div. 2d 495, 236 N.Y.S.2d 88, *appeal denied*, 13 N.Y.2d 598, 245 N.Y.S.2d 1025 (1963).

61. See cases cited notes 51-54 *supra*.

62. See *Schloendorff v. Society of N.Y. Hosps.*, 211 N.Y. 125, 129, 105 N.E. 92, 93 (1914) (Cardozo, J.) ("Every human being of adult years and sound mind has a right to determine what shall be done with his own body . . .").

63. AMERICAN BAR FOUNDATION, *THE MENTALLY DISABLED AND THE LAW* 254 (rev. ed. S. Brakel & R. Rock 1971). See Plotkin, *supra* note 3, at 504 app. (statutory survey as of Dec. 1, 1977).

64. N.J. STAT. ANN. § 30:4-24.2(c) (West Cum. Supp. 1978).

65. R. ALLEN, E. FERSTER & H. WEIHOFEN, *MENTAL IMPAIRMENT AND LEGAL INCOMPETENCY* 49-50 (1968); AMERICAN BAR FOUNDATION, *supra* note 63, at 253; Plotkin, *supra* note 3, at 489 n.170; *Developments in the Law, Civil Commitment of the Mentally Ill*, 87 HARV. L. REV. 1190, 1214 nn.80 & 81 (1974) [hereinafter cited as *Civil Commitment*]; accord, *Vecchione v. Wohlge-muth*, 377 F. Supp. 1361, 1372 (E.D. Pa. 1974); *McAuliffe v. Carlson*, 377 F. Supp. 896, 905 (D. Conn. 1974); *Wyatt v. Stickney*, 344 F. Supp. 387, 399 (M.D. Ala. 1972), *aff'd sub nom. Wyatt v. Aderholt*, 503 F.2d 1305 (5th Cir. 1974).

66. Civil commitment, while not equivalent to an adjudication of general incompetency, arguably implies a finding that the patient is unable to make a *specific* kind of decision—his or her need for treatment. By this reasoning, the state is justified in exercising its *parens patriae* authority to override the patient's incompetent refusal.

This argument was adopted by the Minnesota Supreme Court in rejecting a section 1983

A presumption of incapacity, based solely on a commitment order, not only conflicts with the express language of most statutes, it also fails to withstand constitutional scrutiny. Because of the lack of congruence between mental illness and inability to make rational decisions about one's welfare, due process requires at a minimum a judicial finding of incapacity before the patient is deprived of his fundamental right to refuse treatment.⁶⁷ In *Winters v. Miller*,⁶⁸ the United States Court of Appeals for the Second Circuit found that forcible medication of an involuntarily committed Christian Scientist could constitute a violation of the patient's first amendment rights.⁶⁹ Coercive treatment might be permissible if the state stood in a *parens patriae* relationship to the pa-

claim against state officials who had administered twenty electroshock treatments to an involuntarily confined minor, over the express objections of his natural guardian. The court observed:

The state's interest in assuming the [treatment] decision is in acting as *parens patriae*, fulfilling its duty to protect the well-being of its citizens who are incapable of so acting for themselves. . . . [T]hat interest can be articulated as the need for the state to assume the decision-making role regarding the psychiatric treatment for one who, presumptively, based on the fact of commitment on the ground of mental illness, is unable to *rationaly* do so for himself. If that interest of the state is sufficiently important to deprive an individual of his physical liberty, it would seem to follow that it would be sufficiently important for the state to assume the treatment decision.

Price v. Sheppard, 307 Minn. 250, 258-59, 239 N.W.2d 905, 911 (1976) (footnotes omitted).

In support of its position, the court cited an influential *Harvard Law Review* survey of the law on civil commitment:

Inherent in the adjudication that an individual should be committed under the state's *parens patriae* power is the decision that he can be forced to accept the treatments found to be in his best interest; it would be incongruous if an individual who lacks capacity to make a treatment decision could frustrate the very justification for the state's action by refusing such treatments.

Id. at 259, 239 N.W.2d at 911 (citing *Civil Commitment*, *supra* note 65, at 1344). The citation is disingenuous. The quoted passage refers to a proposed revision in the current system of civil commitment that would make an explicit judicial finding of incapacity a threshold requirement for commitment under the *parens patriae* power. *Id.* at 1212-19. Yet the Minnesota statutes flatly provide that "[c]ommitment . . . is not a judicial determination of legal incompetency." MINN. STAT. ANN. § 253A.18(1) (West 1971). While commitment in Minnesota *may* be based on an individual's incapacity to provide for his basic needs, including medical care, such a finding is not a necessary prerequisite to institutionalization. *See id.* § 253A.07(17)(a) (West Cum. Supp. 1978).

For a discussion of the origins and nature of the *parens patriae* power, see *Civil Commitment*, *supra* note 65, at 1207-12. *See also* O'Connor v. Donaldson, 422 U.S. 563, 582-83 (1975) (Burger, C.J., concurring).

For an excellent discussion of the standards for evaluating a patient's capacity to make treatment decisions, see Roth, Meisel & Lidz, *Tests of Competency to Consent to Treatment*, 134 AM. J. PSYCH. 279 (1977).

67. *Civil Commitment*, *supra* note 65, at 1213-15, 1350-51. Civil commitment to a mental hospital necessarily results in a drastic curtailment of the individual's liberty and privacy. Involuntary confinement does not, however, entitle the state to further deprive the patient of his or her fundamental rights, in the absence of a strong governmental interest. Forcible treatment is a significantly greater invasion of privacy than mere institutionalization and therefore must be specifically justified in an appropriate hearing. *See* Clonce v. Richardson, 379 F. Supp. 338 (W.D. Mo. 1974) (transfer of prisoner to involuntary behavior modification program requires hearing).

68. 446 F.2d 65 (2d Cir.), *cert. denied*, 404 U.S. 985 (1971).

69. The decision could be construed narrowly in view of the special first amendment consid-

tient, but, the court insisted, such a relationship can only be created by a judicial determination of incompetency.⁷⁰

The limits on state action suggested in *Winters* have been clearly recognized in the Third Circuit. In *Scott v. Plante*,⁷¹ the court of appeals found that the forcible administration of drugs to an involuntarily committed mental patient could constitute a violation of due process.

[O]n this record we must assume that Scott, though perhaps properly committable, has never been adjudicated an incompetent who is incapable of giving an informed consent to medical treatment. Under these circumstances due process would require in the absence of an emergency, that some form of notice and opportunity to be heard be given to Scott or to someone standing *in loco parentis* to him before he could be subjected to such treatment.⁷²

Thus, the right to refuse treatment is not lost by the mere fact of involuntary commitment. But it has been suggested that the sweep of the privacy right, while encompassing the most intrusive treatments, is not so broad as to preclude forcible administration of "conventional" therapies.⁷³ The case cited most frequently in support of a constitutional right against treatment, *Kaimowitz v. Michigan Department of Public Health*,⁷⁴ involved a drastic form of medical intervention. After seventeen years of confinement under a criminal sexual psychopath statute, "John Doe" consented to experimental psychosurgery aimed at treating "uncontrollable aggression." Plaintiff Kaimowitz, a civil liberties attorney, asked for a declaratory judgment on the legality of the

erations. Yet the language clearly suggests that a broader application was intended. See *id.* at 71 (discussion of the need for a prior competency determination).

70. *Id.* See also *N.Y. City Health & Hosp. Corp. v. Stein*, 70 Misc. 2d 944, 335 N.Y.S.2d 461 (1972).

71. 532 F.2d 939 (3rd Cir. 1976).

72. *Id.* at 946 (citing *Winters*).

Forcible treatment premised on the mere fact of civil commitment, without an explicit finding of incompetency, may also violate the requirements of equal protection. The physically ill are free to decline treatment, even if intervention is medically indicated. Since mental illness does not necessarily imply any impairment of the ability to make competent decisions about treatment, the state cannot, without more, deny that right to the involuntarily committed. *Civil Commitment*, *supra* note 65, at 1215-16. See *Winters v. Miller*, 446 F.2d 65, 68 (2d Cir. 1971). See also *Lessard v. Schmidt*, 349 F. Supp. 1078, 1094 (E.D. Wis. 1972) (dictum) (three-judge court), *vacated and remanded on other grounds*, 414 U.S. 473 (1974).

73. See, e.g., *Price v. Sheppard*, 307 Minn. 250, 239 N.W.2d 905 (1976) (judicial hearing required before state may administer "the more intrusive forms of treatment," including psychosurgery or electroshock therapy); A. STONE, *MENTAL HEALTH AND LAW* 97-108 (1976) (full protection for right to refuse only for the "more severe" therapies, including psychosurgery and electroshock, but excluding psychotropic drugs).

74. No. 73-19434-AW (Cir. Ct., Wayne County, Mich., July 10, 1973), *reprinted in* A. BROOKS, *LAW, PSYCHIATRY AND THE MENTAL HEALTH SYSTEM* 902 (1974) and 2 *PRISON L. REP.* 433 (1973).

proposed operation.⁷⁵ Emphasizing the intrusiveness of the procedure, the high risks and uncertain benefits,⁷⁶ and the erosion of the subject's decisionmaking capabilities caused by years of institutionalization,⁷⁷ a three-judge county court held that an involuntarily detained mental patient cannot give informed and legally adequate consent to experimental psychosurgery.⁷⁸ The court found compelling constitutional reasons to support its conclusion. Experimental psychosurgery on involuntarily confined mental patients conflicted with the first amendment guarantee of freedom to think and generate ideas.⁷⁹ It also violated the constitutional right of privacy.⁸⁰

In *Rennie*, defendants argued strenuously that *Kaimowitz* was entirely inapposite: the use of widely accepted antipsychotic drugs for legitimate therapeutic purposes could not be equated with experimental psychosurgery. The court, finding the distinction persuasive in the first amendment context, held that forcible drug treatment did not seriously interfere with Rennie's freedom of expression or mentation.⁸¹

The court could have adopted the same distinction in response to Rennie's privacy claim. A narrow reading of the privacy right would protect the unconsenting patient from the most "intrusive" therapies, but leave psychiatrists complete discretion to administer "conventional" treatments. In *Roe v. Wade*, the Supreme Court cautioned that "only personal rights that can be deemed 'fundamental' or 'implicit in the concept of ordered liberty' are included in this guarantee of personal privacy."⁸² When the intrusion is minor or fleeting, no constitutional rights are implicated.⁸³

75. See A. Brooks, *supra* note, 74 at 902-03.

76. *Id.* at 906-10.

77. *Id.* at 914.

78. *Id.* at 916.

79. *Id.* at 916-19.

80. If one is not protected in his thoughts, behavior, personality, and identity, then the right of privacy becomes meaningless. . . .

To hold that the right of privacy prevents laws against dissemination of contraceptive material as in *Griswold v. Connecticut*, or the right to view obscenity in the privacy of one's home as in *Stanley v. Georgia*, but that it does not extend to the physical intrusion in an experimental manner upon the brain of an involuntarily detained mental patient is to denigrate the right. In the hierarchy of values, it is more important to protect one's mental processes than to protect even the privacy of the marital bed.

Id. at 920.

81. 462 F. Supp. at 1143-44. See note 29 *supra*.

82. 410 U.S. 113, 152 (1973); cf. *Doe v. Commonwealth's Attorney*, 403 F. Supp. 1199 (E.D. Va. 1975), *aff'd mem.*, 425 U.S. 901 (1976) (homosexual acts not protected by right of privacy).

83. See, e.g., *Whalen v. Roe*, 429 U.S. 589 (1977) (computerized storage of data on patients receiving prescriptions for dangerous drugs); *Kelly v. Johnson*, 425 U.S. 238 (1976) (length of policeman's hair); *Paul v. Davis*, 424 U.S. 693 (1976) (damage to reputation); cf. *Zablocki v.*

Especially stringent controls for certain intrusive treatments may indeed be appropriate for legislative regulation of coercive therapy.⁸⁴ The *Rennie* court was correct, however, in not limiting the constitutional privacy protection to a narrow range of therapeutic interventions. While psychosurgery, electroshock and aversive conditioning have generally been considered the most drastic forms of treatment,⁸⁵ clinical studies suggest that treatment with psychotropic drugs, especially the neuroleptics, may be equally "intrusive."⁸⁶ The extensive side effects of psychotropics, in conjunction with the uncertainty of psychiatric diagnoses⁸⁷ and doubts about the long-term effectiveness of drug therapy,⁸⁸ compel the conclusion that forcible medication, in the absence of an emergency, infringes the patient's constitutionally protected zone of privacy.⁸⁹

Developed in the early 1950s, psychotropic drugs achieved rapid acceptance as the treatment of choice for a wide variety of mental disorders.⁹⁰ The pharmacological revolution in psychiatry has enabled many previously untreatable patients to live outside the institution.⁹¹ Yet, in some cases, the cost of treatment outweighs the benefit.

Redhail, 434 U.S. 374 (1978) (substantial interference with right to marry); *Carey v. Population Servs. Int'l.*, 431 U.S. 678 (1977) (restrictions on distribution of contraceptives); *Planned Parenthood v. Danforth*, 428 U.S. 52 (1976) (state regulation of abortion).

84. See generally Plotkin, *supra* note 3, at 497-502; Shapiro, *supra* note 1; see also Atkins & Lauriat, *Psychosurgery and the Role of Legislation*, 54 B.U.L. REV. 288 (1974); Note, *supra* note 5, at 396-412 (regulation of electroconvulsive treatment).

85. See, e.g., statutes cited notes 5-7 *supra*.

86. For a review of the research concerning the side effects of antipsychotic drugs, see DuBose, *supra* note 23, at 1202-09. See also studies cited in Plotkin, *supra* note 3, at 474-78. Cf. S. HALLECK, *supra* note 11, at 225-26 (comparing risks of electroconvulsive and drug therapy); Gardos & Cole, *Maintenance of Antipsychotic Therapy: Is the Cure Worse than the Disease?*, 133 AM. J. PSYCH. 32 (1976).

87. See note 21 *supra*.

88. See DuBose, *supra* note 23.

89. See, e.g., DuBose, *supra* note 23 (substantive due process); Ferleger, *Loosing the Chains: In-Hospital Civil Liberties of Mental Patients*, 13 SANTA CLARA L. REV. 447, 473 (1973); Plotkin, *supra* note 3, at 493; Schwartz, *In the Name of Treatment: Autonomy, Civil Commitment, and Right to Refuse Treatment*, 50 NOTRE DAME LAW. 808, 841 (1975); Shapiro, *supra* note 1, at 273-76; Note, *supra* note 3, at 661-65; Comment, *Forced Drug Medication of Involuntarily Committed Mental Patients*, 20 ST. LOUIS U.L.J. 100, 104-05 (1975); Note, *Advances in Mental Health: A Case for the Right to Refuse Treatment*, 48 TEMPLE L.Q. 354 (1975); Note, *The Constitutional Right to Treatment for Involuntarily Committed Mental Patients—What Limitations?*, 14 WASHBURN L.J. 291, 305 (1975). See also Op. Cal. Atty Gen., No. CV 74-327 (Dec. 17, 1975), summarized in 1 ABA MENTAL DISABILITY L. REP. 17 (1976) (refusal of medical treatment falls within zone of privacy protected by first, fourth, fifth and ninth amendments). But see A. STONE, *supra* note 73, at 97-108 (right to refuse should not extend to "conventional" therapies, including psychotropic drugs).

90. Winick, *supra* note 11, at 778-89.

91. *Id.* at 780-81.

All psychotropics cause numerous side effects, some of them extremely serious. Common autonomic effects of neuroleptics include blurred vision, constipation, decreased blood pressure and skin rashes.⁹² Extrapyramidal dysfunctions, or disorders of movement, also accompany treatment with antipsychotics.⁹³ The most common of these disorders is the parkinsonian syndrome, characterized by akinesia (loss of mobility) and muscular rigidity.⁹⁴ Other such disorders include acute dystonia, described as "bizarre-appearing muscle spasms" in the head and neck area,⁹⁵ and akathisia, which is characterized by agitation, restlessness, inability to sit still and insomnia.⁹⁶ Most of these disorders are temporary, however, and can be treated with other drugs.

On the other hand, tardive dyskinesia, the most severe extrapyramidal dysfunction, is generally irreversible. Usually occasioned by prolonged use of psychotropics at high dosages, this syndrome is characterized by chronic, bizarre and involuntary movement of the face, mouth and tongue, and may also involve writhing of the arms, trunk and pelvis. It is estimated that between twenty and forty percent of those who have been treated with neuroleptics develop tardive dyskinesia.⁹⁷

CONCLUSION

Rennie v. Klein represents a significant and controversial⁹⁸ advance in the recognition of rights for mental patients. The New Jersey District Court has articulated a sound constitutional rationale for the right of an involuntarily confined patient to refuse psychotropic medication.

Of course, the definition of a constitutional right does not determine the issue; it merely establishes the context in which the interests of the state and the individual are weighed by a neutral arbiter.⁹⁹ To

92. S. HALLECK, *supra* note 11, at 201-02.

93. L. GOODMAN & A. GILMAN, *supra* note 26, at 169; S. HALLECK, *supra* note 11, at 203.

94. The syndrome places severe restrictions not only upon the patient's mobility but also on psychological behavior, interpersonal relationships, and mental processes. The patient moves slowly and stiffly, speech is monotonous in tone, with difficulty in raising its volume. In severe forms there is major loss of arm movement, a stooped shuffling gait, pill-rolling movements of the hands, and excessive salivation.

S. HALLECK, *supra* note 11, at 203.

95. *Id.* at 204.

96. *Id.*

97. *Id.* at 204-05. See L. GOODMAN & A. GILMAN, *supra* note 26, at 170, 172.

98. See Roth, *Judicial Action Report*, PSYCH. NEWS, Feb. 2, 1979, at 15; Stone, *Recent Mental Health Litigation: A Critical Perspective*, 134 AM. J. PSYCH. 273, 278 (1977).

99. The arbiter need not be the judiciary. An independent review panel, with psychiatrists and nonpsychiatrists as members, could be given broad discretionary authority. *Rennie* explicitly

override a patient's refusal of medication, the state must demonstrate that it has a strong interest in treatment¹⁰⁰ and that it has exhausted all less intrusive alternatives.¹⁰¹ The arbiter must consider the state's interests in the light of the patient's capacity to make a competent treatment decision and the risk of permanent side effects from the proposed therapeutic intervention.¹⁰² The difficulty that the court experienced in trying to apply its constitutional standards to Rennie's case¹⁰³ exemplifies the hazards of judicial involvement in complex treatment issues. Yet, in the absence of adequate protection by statute, the courts have a duty to safeguard the patient's right to refuse treatment. Other courts will confront the issue of forcible treatment with psychotropic drugs in

contemplates the possibility of a state-created "independent administrative board to review treatment decisions." 462 F. Supp. at 1147.

100. Governmental invasions of bodily privacy require more than a minimal justification. L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 914-15 (1978). Whether the state interest must be not only strong, but "compelling," surely depends on the extent of the intrusion.

101. 462 F. Supp. at 1146-47. The classic exposition of this concept was rendered by the Supreme Court in *Shelton v. Tucker*, 364 U.S. 479, 488 (1960) (footnotes omitted):

[E]ven though the governmental purpose be legitimate and substantial, that purpose cannot be pursued by means that broadly stifle fundamental personal liberties when the end can be more narrowly achieved. The breadth of legislative abridgement must be viewed in the light of less drastic means for achieving the same basic purpose.

See *O'Connor v. Donaldson*, 422 U.S. 563, 575 (1975) (principle applied to confinement of the mentally ill); *Price v. Sheppard*, 307 Minn. 250, 257, 239 N.W.2d 905, 910 (1976) (principle applied to choice of treatment for the unconsenting patient).

102. 462 F. Supp. at 1148. Similar balancing tests have been proposed elsewhere. See *Price v. Sheppard*, 307 Minn. 250, 262-63, 239 N.W.2d 905, 913 (1976); Note, *supra* note 3, at 658.

103. In its November 9 opinion, the court ordered the hospital to give Rennie a "fair trial" on a voluntary regimen of lithium and an antidepressant before seeking to treat him involuntarily with antipsychotic drugs. 462 F. Supp. at 1146. Claiming to be unaware of the patient's current status, the court declined to rule on Rennie's motion for a preliminary injunction. *Id.* at 1148.

After the opinion was issued, Rennie's mental and physical condition rapidly deteriorated. He refused to take the medication to which he had previously consented. In response to the patient's "floridly psychotic" condition the hospital began forcible administration of thorazine, a neuroleptic, on December 2. *Id.* at 1151-52. After a one-day hearing, the court denied the motion for a preliminary injunction and declared its decision to be conclusive for at least two months, "barring any significant evidence of tardive dyskinesia or drastic change in any other relevant factor." *Id.* at 1154.

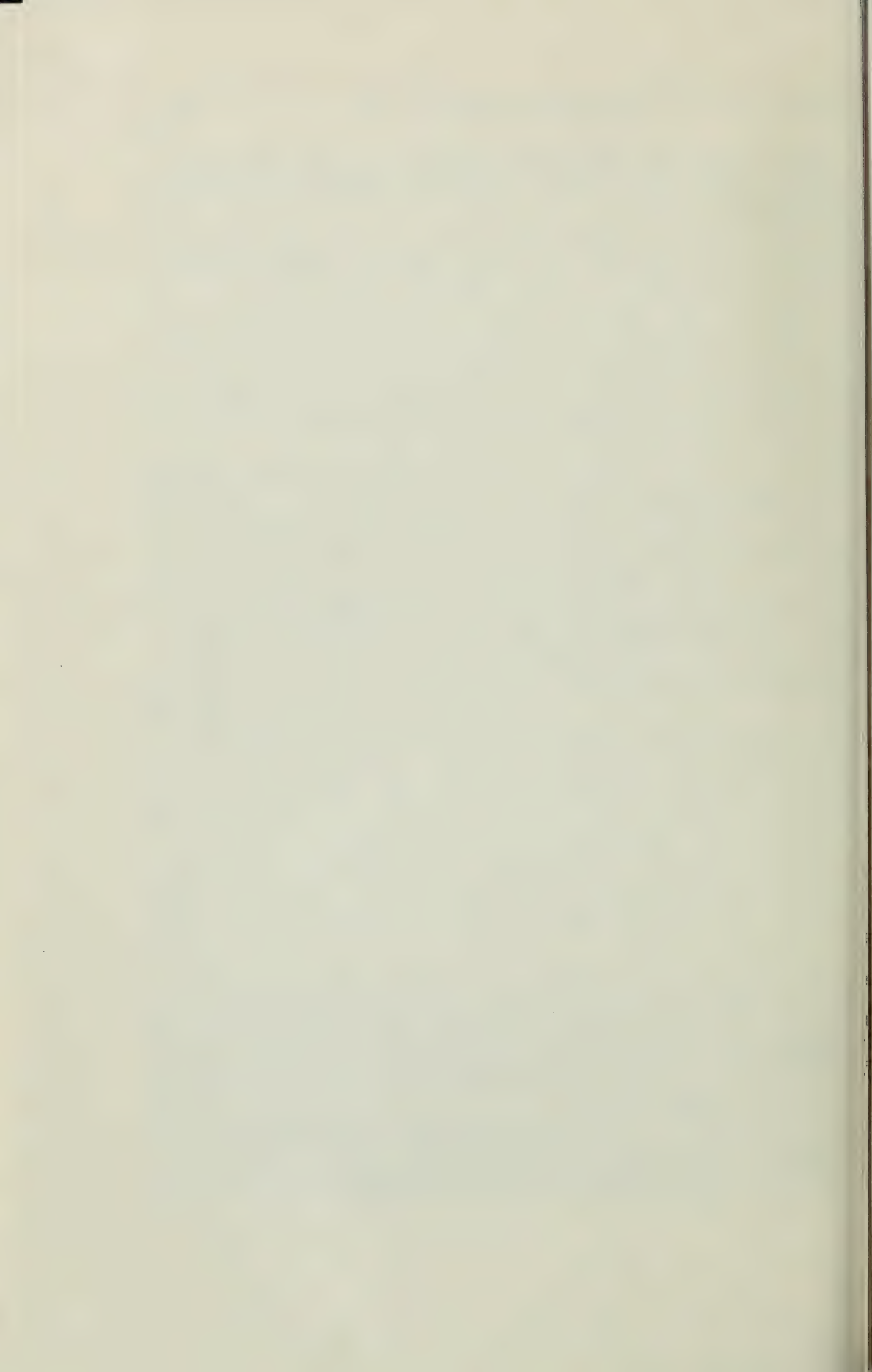
Finally, in *Rennie v. Klein*, 48 U.S.L.W. 2211 (D.N.J. Sept. 14, 1979), the court fashioned the procedural due process necessary to protect the right to refuse treatment. The court held that before a mental patient is given medication he must furnish affirmative written consent on a form that contains information on drugs and patient rights. If a physician certifies that a patient is incapable of giving informed consent, the state must provide a "patient advocate"—a person trained in the effects of psychotropic medication and the principles of legal advocacy, but not necessarily an attorney—to represent the interests of the patient. The court's order "precludes medication of any voluntary patient who does not sign a consent form or who orally refuses, except in emergency situations." *Id.* Before a hospital may forcibly medicate an involuntary patient, there must be an informal review by an independent psychiatrist at which the patient is represented by a patient advocate, or, if the patient prefers, by private counsel. The independent psychiatrist is required to "issue a written decision in each case, basing any decision to override the patient's privacy right on the four factors outlined" in the court's earlier opinion. *Id.*; see 462 F. Supp. at 1145-47.

the near future.¹⁰⁴ If *Rennie's* lead is followed, the states will be compelled to design formal review procedures in accord with constitutional standards.

BURTON CRAIGE

104. A class action to secure the right of state mental hospital inmates to refuse drug treatment has been before a federal district court in Boston for four years. Plaintiffs obtained a temporary injunction against the use of forcible medication at Boston State Hospital. *Rogers v. Okin*, __ F. Supp. __ (D. Mass.), *aff'd without opinion sub nom. Rogers v. Macht*, 566 F.2d 1166 (1st Cir. 1977). See 2 ABA MENTAL DISABILITY L. REP. 192 (1977). The lengthy trial on the merits was nearing completion as this Note went to press.

After a prisoner's section 1983 complaint against prison officials who forcibly treated him with antipsychotic drugs was dismissed by a North Carolina federal district court on defendants' motion for summary judgment, the United States Court of Appeals for the Fourth Circuit remanded the case for an evidentiary hearing to consider the plaintiff's constitutional claim. *Sweezy v. Jones*, No. 78-6034 (4th Cir. Dec. 5, 1978) (unpublished opinion).



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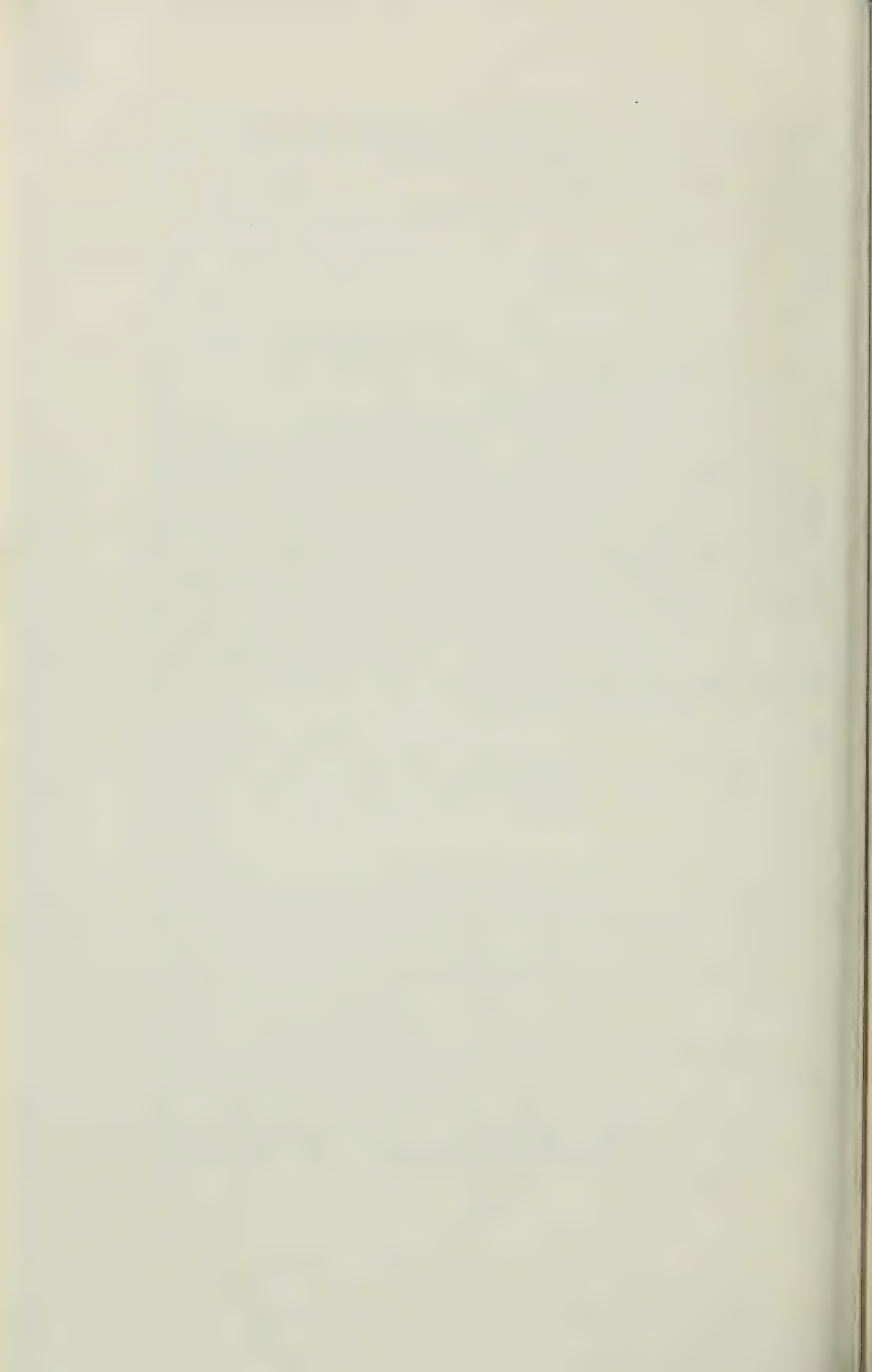
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